Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

JOHN K. CASTLE, ET AL.,

Petitioners,

v.

UNITED STATES,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

JOHN C. MILLIAN
Counsel of Record
THOMAS G. HUNGAR
MARK A. PERRY
PAUL BLANKENSTEIN
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 955-8500

Counsel for Petitioners

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QUESTIONS PRESENTED

1. Whether the court of appeals erred in holding—contrary to decisions of this Court, other courts of appeals, and the RESTATEMENT (SECOND) OF CONTRACTS—that restitution is unavailable as a matter of law when a party performs under a unilateral contract with the federal government and the government then breaches that contract.

2. Whether the court of appeals erred in holding—contrary to decisions of this Court, the Ninth Circuit, and the RESTATEMENT (SECOND) OF CONTRACTS—that intended beneficiaries of a contract with the federal government do not have standing to assert breach of contract claims against the government unless the contract also reflects an intention to benefit them "directly" and "personally."

3. Whether the court of appeals erred in holding, contrary to decisions of this Court, that the availability of contract remedies and the existence of a federal regulatory scheme precludes recovery of just compensation under the Fifth Amendment for the government's taking of private property.

PARTIES AND CORPORATE DISCLOSURE

Pursuant to this Court's Rule 14.1(b), a complete list of petitioners follows: John. K. Castle; Leonard M. Harlan; Donald C. Carter; Double S&M Partnership; Grace & Green Arbitrage Partners; Hudson Valley Partners, L.P.; Dan W. Lufkin; MCI Two Investment Limited Partnership; Robert Marston; McD Merger Arbitrage Fund, Ltd.; L.T. Foster, Northern Trust Co., Trust #2-67917 (Kate T. Foster Trust FBO); R.C. Foster, Northern Trust Co., Trust #2-67918 (Kate T. Foster Trust FBO); J.R. Foster, Northern Trust Co., Trust #2-67929 (Kate S. Thompson Trust FBO); Public Service Resources; Society Bank & Trust-Trustee; Zane Tankel Partners; Robert V. Dolan, M.D.; Leo W. Kwan, M.D. Pension and Profit Sharing Trusts; Robert B. Lyons; Robert Margolis; Fosven Associates Partnership; Stanley E. Roberts, M.D.; Sanwa Bank of California, Trustee, Yorba Linda Medical Group FBO Russel E. Ewing; Castle Harlan, Inc.; and Cewnick Fund.

Pursuant to this Court's Rule 14.1(b), petitioners note that, in addition to the named respondent (the United States), the Federal Deposit Insurance Corporation was an appellee in the court below and, pursuant to this Court's Rule 12.6, is a respondent in this Court.

Pursuant to this Court's Rule 29.6, petitioners note that Public Resources Enterprise Group, a public company, is the parent of Petitioner Public Service Resources (n/k/a PSEG Resources). None of the other petitioners is a publicly traded company or has a publicly traded parent company.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners John K. Castle, *et al.* respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-27a) is reported at 301 F.3d 1328. The opinions of the trial court on the issues of liability and remedies (App., *infra*, 106a-125a; *id.* at 28a-105a) are reported at 42 Fed. Cl. 859 and 48 Fed. Cl. 187, respectively.

JURISDICTION

The judgment below was entered on August 19, 2002. On November 14, 2002, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including December 17, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION INVOLVED

The Fifth Amendment to the Constitution of the United States provides, in pertinent part, "nor shall private property be taken for public use, without just compensation."

STATEMENT OF THE CASE

I. Factual Background

1. This is a breach of contract and Fifth Amendment takings case arising out of the savings and loan crisis of the late 1980s. Throughout most of the 1980s, the Federal Savings and Loan Insurance Corporation ("FSLIC"), the insurer of thrift deposits, lacked suffi-

cient funds to resolve failing savings and loans. Accordingly, the government appealed to the public to help solve the problem, choosing "to convert some of its financial insurance obligations into responsibilities of private entrepreneurs." *United States v. Winstar Corp.*, 518 U.S. 839, 894 (1996). Government regulators entered into a series of "supervisory merger" agreements in which they contractually agreed to afford specified regulatory treatment as an incentive for private investors to contribute capital and take over failing thrifts. *See id.* at 847-51.

In August 1989, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which overhauled the structure of federal thrift regulation. *See Winstar*, 518 U.S. at 856. Among other things, FIRREA established stricter capital requirements and abrogated many of the accounting and operational promises that regulators had made in connection with supervisory mergers. *Id.* at 857. As a result, many institutions immediately fell out of compliance with regulatory capital requirements, making them subject to seizure by thrift regulators. *Id.* at 858. In *Winstar*, this Court ruled that FIRREA had the effect of breaching the supervisory merger contracts at issue there by, among other things, withdrawing the assurances of special regulatory treatment that investors had received from the federal regulators as part of their contracts for the acquisition and recapitalization of failing thrifts. *Id.* at 910. *Winstar* made clear that the United States is liable for FIRREA-related breaches of contract. *Id.* at 870.

2. This case arises out of a similar fact pattern. In 1988, petitioners John K. Castle and Leonard M. Harlan,

who owned a merchant banking firm, Castle Harlan, Inc., were two private investors who answered the government call to recapitalize failing thrifts. They agreed to acquire and recapitalize a failing savings and loan association—Western Empire Savings and Loan Association ("Western Empire")—in exchange for the government's promises that they could operate Western Empire in accordance with a non-traditional business plan. App., *infra*, 7a-8a, 11a. The purpose of the contract "was to enshrine a modified regulatory regime under which Western Empire would operate that would induce investors to recapitalize the thrift." *Id.* at 122a.

On December 30, 1988, the regulators approved petitioners' acquisition and recapitalization of Western Empire, and simultaneously executed the Regulatory Capital Maintenance Agreement ("RCMA"), which was signed by Castle and Harlan, the FSLIC, and Western Empire. The RCMA—which expressly states that it "shall be deemed a contract made under and governed by Federal law" (C.A. App. A500035)—incorporates two other contract documents: the Acquisition Approval Letter with Conditions, issued by the Federal Home Loan Bank Board ("FHLBB") to Castle and Harlan on December 30, 1988, and the Business Plan prepared by Castle and Harlan and approved by the FHLBB. App., *infra*, 109a. In that Business Plan, Castle and Harlan agreed to organize an investor group "in order to recapitalize the association" and called for an infusion of "as much as $26 million" to recapitalize Western Empire, "but in no case will it be less than the amount necessary to capitalize the existing assets at the required rate." *Id.* at 9a.

Castle and Harlan performed under the contract by forming an investor group that contributed $15.12 million in capital to the thrift immediately upon consummation of the acquisition. App., *infra*, 9a, 31a n.1. By approving the transaction, with full knowledge of the identity of the investors and the amount to be contributed, the government acknowledged the sufficiency of petitioners' performance. *Id.* at 9a, 109a. Castle and Harlan individually contributed $500,000 into Western Empire; the other investors, who became shareholders or bondholders of Western Empire and are also petitioners in this case, contributed the remaining $14.6 million. *Id.* at 9a. In exchange for this capital contribution, the government made specific promises as to how petitioners would be permitted to operate their newly acquired thrift. *Id.* at 31a-32a n.2.

Approximately eight months later, Congress enacted FIRREA, which (as implemented by the federal regulators) breached each of the material promises the government had made in exchange for petitioners' investment. App., *infra*, 9a-10a. Because of the government's refusal to adhere to the contract's terms, petitioners' thrift was seized in February 1990. *Ibid.*

II. Proceedings Below

1. In September 1990, Castle, Harlan, and the other investors filed suit in the Court of Federal Claims, alleging that the passage of FIRREA and its implementing regulations breached the government's contractual promises and effected a taking of their property for which the Fifth Amendment requires the government to pay just compensation. App., *infra*, 10a.

a. The parties submitted cross-motions for partial summary judgment regarding liability, and the United States moved to dismiss the plaintiffs other than Castle and Harlan. App., *infra*, 11a. The Court of Federal Claims granted summary judgment in favor of petitioners on the issue of liability and rejected the government's motion to dismiss the non-signatory petitioners. *See id.* at 125a. The trial court held that the petitioners other than Castle and Harlan were third-party beneficiaries of the contract and thus had standing to sue for its breach. App., *infra*, 119a, 122a-123a (citing RESTATEMENT (SECOND) OF CONTRACTS § 304, and *Far West Fed. Bank, S.B. v. Office of Thrift Supervision*, 119 F.3d 1358 (9th Cir. 1997)). "On the merits, the court agreed with the plaintiffs that the Congressional enactment of FIRREA and the promulgation of its implementing regulations breached critical components of the contract." App., *infra*, 12a; *see also id.* at 107a-108a.

b. After a trial on remedies, the Court of Federal Claims held, among other things, that the government owed petitioners restitution in the amount of their $15.12 million initial investment due to the government's breach of contract. App., *infra*, 12a; *id.* at 91a. The trial court found that "what the *government bargained for and received was an infusion of capital* into an ailing bank and the subsequent operation of that bank in accordance with an approved business plan. *The government got what it bargained for; hence, restitution is available*." *Id.* at 91a-92a (emphases added). The trial court also ruled that, because plaintiffs had available contract-based remedies, the Fifth Amendment did not require the payment of just compensation. *Id.* at 100a.

2. A panel of the Federal Circuit reversed the trial court's award of restitution. The panel agreed that Castle and Harlan were direct parties to the contract with the government with standing to sue for its breach. App., *infra*, 19a. The panel stated, however, that "although Castle and Harlan signed the [contract documents] as individuals, they incurred no individual financial liability." *Id.* at 21a. According to the court of appeals, in those circumstances "Castle and Harlan cannot recover restitutionary damages in any amount contributed voluntarily, beyond their contractual obligations." *Ibid.* The panel concluded on this basis that "Castle and Harlan may not recover damages for the government's alleged breach of contract." *Id.* at 24a.

In addition, the court below rejected the trial court's determination that the plaintiffs other than Castle and Harlan had standing to sue as third-party beneficiaries of the contract. App., *infra*, 17a. The panel held that, "'in order to make a shareholder a third party beneficiary, the contract must express the intent of the promisor to benefit the shareholder *personally, independently of his or her status as a shareholder.*'" *Ibid.* (quoting *Glass v. United States*, 258 F.3d 1349, 1353-54 (Fed. Cir. 2001)). The court below determined that the non-signatory plaintiffs "cannot meet the test for third-party beneficiary status articulated in *Glass*, because none of the government's alleged contractual promises conferred benefits upon them personally, apart from their status as shareholders of Western Empire." *Id.* at 18a. The panel expressly recognized that its approach to third-party beneficiary status conflicted with the Ninth Circuit's approach in *Far West*, because the Federal Circuit in *Glass*

"adopted a test more stringent than the one applied in *Far West*." App., *infra*, 16a.

Finally, the court below affirmed the trial court's determination that petitioners did not suffer a compensable taking under the Fifth Amendment. App., *infra*, 25a. Relying on *Branch ex rel. Maine National Bank v. United States*, 69 F.3d 1571, 1575 (Fed. Cir. 1995), the panel held that "seizure of Western Empire for failure to comply with the regulatory requirements imposed by FIRREA did not constitute a taking." App., *infra*, 25a. Thus, the court stated, the only property allegedly taken "was the plaintiffs' contract." *Id.* at 26a. The court rejected petitioners' contention "that the Fifth Amendment entitles them to just compensation beyond damages for breach of contract." *Ibid.* The court reasoned that "the plaintiffs retained the full range of remedies associated with any contractual property right they possessed. Consequently, we hold that even assuming the enactment and enforcement of FIRREA breached a contract the government had with Castle and Harlan, it did not constitute a taking of the contract." *Id.* at 26a.[1]

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[1] Petitioners submitted a timely petition for rehearing *en banc* on October 17, 2002. The clerk of the court below refused to file the petition solely because of an alleged defect in form, in contravention of Federal Rule of Appellate Procedure Rule 25(a)(4), and a panel of the Federal Circuit refused to direct the clerk to perform his nondiscretionary duty. Petitioners are filing a petition for a writ of mandamus with this Court simultaneously with this petition. Should this Court issue a writ of mandamus directing the clerk of the court below to file petitioners' timely petition for rehearing *en banc*, it would be appropriate to hold this petition for a writ of certiorari in abeyance pending the Federal Circuit's consideration of the petition for rehearing *en banc*.

The effect of the Federal Circuit's decision is to preclude petitioners from receiving any compensation in this case, notwithstanding the government's clear breach of contract and petitioners' undisputed loss of over $15 million.

REASONS FOR GRANTING THE WRIT

I. The Federal Circuit's Contract-Based Holdings Denying Restitution And Third-Party Beneficiary Status To Petitioners Warrant This Court's Review

In holding the United States liable for FIRREA-induced breaches of contract in *Winstar*, this Court explained that "we have, of course, followed the Federal Circuit in applying ordinary principles of contract construction and breach that would be applicable to any contract action between private parties." 518 U.S. at 870-71 (plurality opinion). Since that time, however, the Federal Circuit has repeatedly abandoned that approach to government contract claims in a series of decisions, including the decision below, that have failed to apply the traditional law of contracts in cases involving government contracts. In combination, those decisions have all but eviscerated this Court's central holding in *Winstar* by adopting special rules to relieve the government of its obligation to pay compensation for its adjudicated breaches of contract. In virtually every post-*Winstar* case, the Federal Circuit has failed to adhere to well-established principles of contract law as set forth in the RESTATEMENT and this Court's precedents.

While space considerations preclude an exhaustive analysis of the Federal Circuit's pervasive pattern of creating special rules for the government in contract cases, a few examples are illustrative. In *Glendale*, the

Federal Circuit ignored black-letter law and refused to allow an award of restitution notwithstanding the trial court's express factual findings as to the amount of benefit conferred at the time of contracting. *Glendale Fed. Bank, FSB v. United States*, 239 F.3d 1374, 1378, 1382 (Fed. Cir. 2001). In *CalFed*, the Federal Circuit disregarded decades of precedent, including this Court's, and refused to look past the date of replacement in determining replacement cost damages. *California Fed. Bank, FSB v. United States*, 245 F.3d 1342, 1350-51 (Fed. Cir. 2001), *cert. denied*, 534 U.S. 1113 (2002). In *Glass*, as explained in more detail below, the Federal Circuit expressly disagreed with the Ninth Circuit (and, by extension, the RESTATEMENT) in creating a new, and invalid, requirement for third-party beneficiaries. *Glass*, 258 F.3d at 1353-54. And in this case, the Federal Circuit denied petitioners the restitutionary recovery due them under well-established principles of contract law, by establishing the unprecedented rule that restitution is unavailable when a party performs under a unilateral contract with the government.

The decision below is simply the most recent, and most egregious, example of the Federal Circuit's misguided approach to the federal common law of contracts. In decision after decision, the court has demonstrated its willingness to ignore or distort established principles of contract law in order to hand victory to the government. This Court's decision in *Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604, 607 (2000)—which ordered the Federal Circuit, in no uncertain terms, to adhere to the RESTATEMENT in cases involving government contracts—has gone unheeded in the Federal Circuit. This case presents the Court with

the opportunity to remedy not only the gross injustice visited upon these petitioners by the Federal Circuit, but also to correct that court's continuing disregard of this Court's mandate in *Mobil Oil*. The Federal Circuit is repeatedly and consistently refusing to hold the United States to the legal standards applicable to private contractors, with the result that petitioners and others who relied to their detriment on the government's promises are now being precluded from obtaining meaningful judicial relief from the government's breach of those promises. This Court's review is essential to compel compliance with *Mobil Oil* and *Winstar*, to resolve the circuit conflicts created by the decision below, and to ensure that the government is held to the same standards as any other entity that willfully breaches its contracts.

A. The Federal Circuit's Preclusion Of Restitution In Cases Involving Unilateral Contracts Conflicts With Decisions Of This Court And Other Courts Of Appeals And With Fundamental Principles Of Contract Law

This Court has made clear that the basic principles of restitution set forth in the RESTATEMENT (SECOND) OF CONTRACTS must be applied to contract claims against the government. *See, e.g.*, *Mobil Oil*, 530 U.S. at 607; *Winstar*, 518 U.S. at 895. The court below ignored this mandate in holding, contrary to the RESTATEMENT, that as a matter of law a party who performs under a unilateral contract with the government is not entitled to restitution in the event of the government's subsequent breach. App., *infra*, 21a. That holding not only conflicts with well-established contract law embodied in the RESTATEMENT (SECOND) OF CONTRACTS and the RESTATEMENT OF RESTITUTION—and thereby violates this Court's holdings in *Mobil Oil* and *Winstar*—but it

creates a split in authority with the Ninth and Tenth Circuits. Accordingly, further review is warranted.

1. Restitution of a benefit provided by the nonbreaching party pursuant to a contract is a well recognized and generally available remedy for breach of contract. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 344, 345; *id.*, Chapter 16 (Remedies), Topic 4 (Restitution), Introductory Note at 199; RESTATEMENT OF RESTITUTION § 108. There is no dispute in this case that petitioners Castle and Harlan performed under the contract by causing $15.12 million in new capital to be contributed to Western Empire and that "[t]he government got what it bargained for." App., *infra*, 92a. Nor is there any dispute that the enactment and enforcement of FIRREA constituted a governmental breach of that contract. *Id.* at 6a. Nevertheless, the Federal Circuit held that Castle and Harlan could not obtain restitution for the government's breach of contract because they "incurred no individual financial liability." *Id.* at 21a. According to the Federal Circuit, "Castle and Harlan cannot recover restitutionary damages in any amount contributed voluntarily, beyond their contractual obligations." *Ibid.*

a. The court below did not disturb the trial court's factual finding that Castle and Harlan caused $15.12 million to be contributed to Western Empire pursuant to their contract with the government, and that this contribution constituted performance under the contract. App., *infra*, 91a-92a. Nonetheless, the court of appeals held that the fact that petitioners *performed* under the contract was insufficient to entitle them to restitution unless they were previously *obligated* to perform in that manner. App., *infra*, 21a. Assuming *arguendo* that the

court of appeals correctly construed the contractual relationship, the effect of its holding is to preclude restitution as a remedy in *all* unilateral contract cases, because such contracts by definition are not binding unless and until accepted by performance. *See* 1 E. ALLAN FARNSWORTH, CONTRACTS § 3.4, at 189 (2d ed. 1998) ("In forming a unilateral contract only one party makes a promise: the offeror makes the promise contained in the offer, and the offeree renders some performance as acceptance"). *See also* 1 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1:17, at 44-46 (Richard A. Lord ed., 4th ed. 1990); RESTATEMENT (SECOND) OF CONTRACTS § 53; *see also id.* §§ 30, 45. Thus, since the party who accepts a unilateral contract by performance is never *obligated* to do so but instead does so "voluntarily" (App, *infra*, 21a), the decision below makes restitution unavailable as a matter of law under all such contracts notwithstanding the offeror's failure to perform its side of the bargain.

The Federal Circuit's holding that performance of a unilateral contract does not give rise to a right to restitution is flatly contrary to this Court's precedents, well-established contract principles embodied in the RESTATEMENT (SECOND) OF CONTRACTS and the RESTATEMENT OF RESTITUTION, and decisions of other courts of appeals. The RESTATEMENT makes clear that the right to restitution arises from the non-breaching party's *performance* under the contract, and is not dependent on whether there was a preexisting *obligation* to perform. Thus, the RESTATEMENT explains that restitution is intended to "prevent the unjust enrichment" of the breaching party, and thus "requires [that] party to disgorge the benefit he has received by returning it to the

party who conferred [the benefit]." RESTATEMENT (SECOND) OF CONTRACTS § 344, cmt. *a*. When one party breaches, the "injured party is entitled to restitution for *any benefit* that he has conferred on the other party by way of *part performance* or reliance." *Id.* § 373 (emphasis added); *see also id.*, Chapter 16 (Remedies), Topic 4 (Restitution), Introductory Note, at 199 ("A party who has received a benefit at the expense of the other party to the agreement is required to account for it, either by returning it in kind or by paying a sum of money"). The proper focus, therefore, is on the breaching party's receipt of a *benefit* under the contract—not on whether the non-breaching party had a preexisting *obligation* to confer that benefit.

In order to determine whether a benefit has been conferred on the breaching party, courts generally look to the terms of the agreed exchange. *See* RESTATEMENT (SECOND) OF CONTRACTS § 370, cmt. *a* ("The benefit is ordinarily conferred by performance by the party seeking restitution, and receipt by the other party of performance that he bargained for is regarded as a benefit"); *id.* ("The other party is considered to have had a benefit conferred on it if a performance was rendered at his request to a third person"). Although a "person who officiously confers a benefit upon another is not entitled to restitution therefor," a "person who has conferred a benefit upon another in the performance of a contract or bargain with the other which the other has failed to perform is entitled to restitution." RESTATEMENT OF RESTITUTION §§ 2, 108.

The court of appeals did not upset the trial court's express factual finding that "what the government bargained for and received was an infusion of capital into

an ailing bank .... *The government got what it bargained for.*" App., *infra*, 91a-92a (emphasis added). It is incontrovertible, therefore, that petitioners performed under the contract and, in so doing, conferred a benefit on the government. The court of appeals' refusal to award petitioners restitution for the benefit they conferred on the government—the $15.12 million capital contribution to Western Empire that the government requested—is thus flatly contrary to the RESTATEMENT (SECOND) OF CONTRACTS and the RESTATEMENT OF RESTITUTION.

b. As a result of its failure to adhere to these principles of restitution laid down in the RESTATEMENTS, the panel's decision is irreconcilable with this Court's decisions in *Mobil Oil* and *Winstar*. As those cases explain, "[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Mobil Oil*, 530 U.S. at 607 (quoting *Winstar*, 518 U.S. at 895).[2] In particular, this Court's precedents teach that the basic principles of restitution set forth in the RESTATEMENT (SECOND) OF CONTRACTS must be

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[2] *Accord Lynch v. United States*, 292 U.S. 571, 579 (1934) (plurality opinion); *Clearfield Trust Co. v. United States*, 318 U.S. 363, 369 (1943) ("The United States does business on business terms") (quoting *United States v. National Exch. Bank*, 270 U.S. 527, 534 (1926)); *Perry v. United States*, 294 U.S. 330, 352 (1935) ("When the United States, with constitutional authority, makes contracts, it has rights and incurs responsibilities similar to those of individuals who are parties to such instruments. There is no difference ... except that the United States cannot be sued without its consent.") (internal citation omitted); *United States v. Bostwick*, 94 U.S. 53, 66 (1877); *Cooke v. United States*, 91 U.S. 389, 398 (1875).

applied to contract claims against the government. *See id.* at 607-08. As the *Mobil Oil* Court explained, the "RESTATEMENT OF CONTRACTS reflects many of the principles of contract law that are applicable to this action," including the principles of restitution articulated in § 373 of the RESTATEMENT. *Id.* at 608. Applying those principles to the facts of that case, the Court in *Mobil Oil* ordered restitution by the government of all funds paid under the repudiated oil lease contracts at issue there. *See id.* at 624. By ignoring—and, indeed, contradicting—the principles of restitution articulated in the RESTATEMENT, the decision below flies directly in the face of this Court's pronouncements in *Mobil Oil* and *Winstar*.

2. In addition, the panel's denial of restitution in this context creates a square conflict with decisions of the Ninth and Tenth Circuits. In both *Far West Federal Bank, S.B. v. Office of Thrift Supervision*, 119 F.3d 1358 (9th Cir. 1997), and *RTC v. FSLIC*, 25 F.3d 1493 (10th Cir. 1994), the plaintiffs invested in failing thrifts in exchange for the government's *Winstar*-type contractual promises. *Far West*, 119 F.3d at 1361; *RTC*, 25 F.3d at 1497. Upon the government's subsequent breach of contract, the Ninth and Tenth Circuits awarded the respective investors restitution in the amount of their initial investments. *Far West*, 119 F.3d at 1367; *RTC*, 25 F.3d at 1505. Neither the rationale employed nor the result reached in those decisions can be reconciled with the decision below.

As the Ninth Circuit explained in *Far West*, the RESTATEMENT provides that a "party is entitled to restitution . . . to the extent that he has conferred a benefit on the other party by way of part performance or reliance."

Far West, 119 F.3d at 1366 (quoting RESTATEMENT (SECOND) OF CONTRACTS § 370). The court determined that "there is no question that the Investors conferred *some* benefit on the government. The government actively sought investors to recapitalize Far West. . . . [W]ithout the prospect of [savings on the part of the government], there would have been no incentive for the government to contract with plaintiffs." *Ibid.* (internal citation and quotation marks omitted). The court concluded that, because restitution of the $26.6 million investment in the thrift "fully restores the Investors to their status quo ante, it is a reasonable measure of restitution." *Id.* at 1367.

Similarly, the Tenth Circuit in *RTC* upheld an award of restitution in the amount of the investors' capital contribution to the thrift. Relying on the RESTATEMENT, the court explained that "[t]he purpose of rescission and restitution is to put the plaintiff in as good a position as it enjoyed before the contract was made by requiring the defendant to restore the value of plaintiff's part performance or reliance." *RTC*, 25 F.3d at 1504. Accordingly, the court affirmed the district court's award of restitution measured by the investors' $6 million capital contribution. *Id.* at 1505.

The decisions in *Far West* and *RTC*, which follow this Court's directive to apply the RESTATEMENT (SECOND) OF CONTRACTS to contract claims against the government, are directly contrary to the panel's decision in this case. Every other investor with standing to enforce a *Winstar*-type contract has received the amount of its initial cash investment as restitution. Indeed, had petitioners filed suit in a California district court, the trial court's award of restitution would unquestionably have

been affirmed under the controlling authority of *Far West*. The remedy available for the federal government's breach of contract should not vary from Circuit to Circuit. This Court's review is necessary to resolve this conflict and correct the Federal Circuit's refusal to follow the dictates of this Court's decisions in *Mobil Oil* and *Winstar*.

B. The Federal Circuit's Holding That Intended Beneficiaries Of A Government Contract Lack Standing To Sue For Its Breach Conflicts With Decisions Of This Court, The Ninth Circuit, And The Restatement

The court below held that those petitioners who did not formally sign the contract with the government are not third-party beneficiaries of the contract and thus lack standing to sue for its breach. App., *infra*, 18a. Although the trial court found that the non-signatory petitioners were intended beneficiaries of the contract, the panel held that "shareholders seeking status as third-party beneficiaries of an allegedly breached contract must 'demonstrate that the contract not only reflects the express or implied intention to benefit the party, but that it reflects an intention to benefit the party *directly*.'" *Id.* at 16a-17a (quoting *Glass v. United States*, 258 F.3d 1349, 1354 (Fed. Cir. 2001)). As the panel itself recognized, this approach directly conflicts with the Ninth Circuit's holding in *Far West*. App., *infra*, 16a-17a (citing *Far West*, 119 F.3d at 1363-64). In addition, the decision below conflicts with the RESTATEMENT (SECOND) OF CONTRACTS and with this Court's direction to apply the RESTATEMENT in contract claims against the government. *See, e.g.*, *Mobil Oil*, 530 U.S. at 607; *Winstar*, 518 U.S. at 895. Review of the panel's decision denying

third-party beneficiary status to the non-signatory petitioners in this case is therefore appropriate.

1. Under the RESTATEMENT, a third party who is an "intended beneficiary" of a contract may sue to enforce the contract or to obtain an appropriate remedy for breach. *See* RESTATEMENT (SECOND) OF CONTRACTS § 304 ("A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty"); *see also id.* § 302 ("a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and . . . the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance").

Here, the trial court found that "[i]t is clear . . . that the *'implied intention' of the parties was to benefit the investors*, and that they fall within the class—indeed they comprise the entirety of the class—that was intended to benefit from the government's promises." App., *infra*, 122a-123a (emphasis added). As the trial court explained:

> The very purpose of the contract . . ., as clearly spelled out in the Business Plan of Castle Harlan (and in essence undisputed by the government), was to enshrine a modified regulatory regime under which Western Empire would operate that would induce investors to recapitalize the thrift. The capital these investors would provide was the linchpin of the agreement . . . . *It was for the investors' benefit, to induce their investments, that the government made its promises*.

App., *infra*, 16a (quoting *id.* at 122a) (emphasis added).[3] Notably, the court below did not overturn this finding of the trial court. Thus, under the RESTATEMENT's approach, the petitioners other than Castle and Harlan, as "intended beneficiaries," clearly satisfied the test for third-party beneficiary status.

2. In *Far West*, the Ninth Circuit applied the rule stated in § 304 of the RESTATEMENT that "a third party who is an intended beneficiary of a contract may sue to enforce the contract or to obtain appropriate remedy for breach." *Far West*, 119 F.3d at 1363-64. The Ninth Circuit held, like the trial court in this case, that the circumstances of the *Winstar*-type transaction at issue there "indicate[d] that all of the parties intended the benefits of FHLBB's promises to run to the Investors, so that the Investors would be inclined to risk their money in Far West." *Id.* at 1364. Thus, the Ninth Circuit concluded, "even though the Investors were not signatories to the [contract] itself, it is clear that the sole purpose of the entire transaction . . . was for the Investors to invest $26.6 million in Far West in exchange for promises by the FHLBB to regulate Far West in a manner that would make their investment financially sound." *Ibid.* Accordingly, the Ninth Circuit held that the non-signatory

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[3] Indeed, the non-signatory petitioners in this case consisted of a small group of only twenty-one investors who were identified to the government by name and amount of contribution before the transaction closed. The regulators required signed subscription agreements from the investor group as a condition of closing. The government knew that petitioners were investing in reliance on the government's promises.

investors were third-party beneficiaries of the contract. *See ibid.*

The panel below expressly recognized that its holding regarding third-party beneficiary status conflicts with "the approach to third-party beneficiary status adopted by the Ninth Circuit in *Far West*." App., *infra*, 15a. The panel explained that the Federal Circuit, in *Glass*, had "adopted a test more stringent than the one applied in *Far West*." *Id.* at 16a. Under the Federal Circuit's "more stringent" test for third-party beneficiary status, "'in order to make a shareholder a third party beneficiary, the contract must express the intent of the promisor to benefit the shareholder *personally, independently of his or her status as a shareholder*.'" *Ibid.* (quoting *Glass*, 258 F.3d at 1353-54).[4] Applying this test, the panel below determined that the non-signatory petitioners "cannot meet the test for third-party beneficiary status articulated in *Glass*, because none of the government's alleged contractual promises conferred bene-

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[4] The court in *Glass* relied on Section 302 of the RESTATEMENT, which distinguishes between intended and incidental beneficiaries. *See Glass*, 258 F.3d at 1354 (citing RESTATEMENT (SECOND) OF CONTRACTS § 302, illus. 2). This provision—which states that "a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and . . . the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance"—offers no support for the court's "direct benefit" test. Indeed, as Section 313 of the RESTATEMENT makes clear, the "direct benefit" test is inapplicable to contracts, such as the one here, that manifest an intention to benefit identifiable individuals rather than members of the public at large. *See* RESTATEMENT (SECOND) OF CONTRACTS § 313 & cmt. *a*.

fits upon them personally, apart from their status as shareholders of Western Empire." *Ibid.*

3. The decision below cannot be reconciled with the Ninth Circuit's decision in *Far West*, the RESTATEMENT or *Mobil Oil*, none of which imposes the Federal Circuit's concededly "more stringent" test for third-party beneficiary status. Indeed, although the test announced in *Glass* conflicts with the RESTATEMENT (SECOND) OF CONTRACTS—and thereby contravenes this Court's teaching in *Mobil Oil* and *Winstar*—the Federal Circuit has firmly adopted and adhered to this view. *See Glass*, 258 F.3d at 1354, *reh'g denied*, 2001 U.S. App. LEXIS 27141 (Fed. Cir. Nov. 15, 2001); App., *infra*, 16a.

Moreover, the court below expressly recognized that its "more stringent" test conflicts with the Ninth Circuit's approach, rendering an intended beneficiary's choice of forum to pursue a contract claim outcome-determinative. But the federal common law of contracts should apply uniformly from jurisdiction to jurisdiction. *See, e.g.*, ROBERT L. STERN, ET AL., SUPREME COURT PRACTICE § 4.21 at 264 (8th ed. 2002) ("the [Federal Circuit] is of equal rank with the regional courts of appeals, and a conflict between a decision of the Federal Circuit and that of another court of appeals is relevant to issuance of the writ to review either of the conflicting decisions"). Again, had petitioners in this case filed suit in a California district court rather than the Court of Federal Claims, the non-signatory petitioners' standing to sue for the government's breach would have been upheld. Review by this Court of the Federal Circuit's "more stringent" test is therefore necessary to resolve these conflicts.

C. The Federal Circuit's Continued Refusal To Enforce Basic Principles Of Contract Law Against The Government Presents Recurring And Important Issues That Merit This Court's Review

The contract-based questions presented in this petition are frequently recurring and exceedingly important. They both ask, in essence, whether it is still true that "'[w]hen the United States enters into contract relations, its rights and duties therein are governed by the law applicable to contracts between private individuals.'" *Mobil Oil*, 530 U.S. at 607 (quoting *Winstar*, 518 U.S. at 895). Although this Court has repeatedly made clear that "[t]he United States does business on business terms," *Winstar*, 518 U.S. at 895 n.39 (quoting *Clearfield Trust Co. v. United States*, 318 U.S. 363, 369 (1943)), the Federal Circuit's decision in this case once again calls into question that fundamental principle.

The decision below, if not corrected by this Court, effectively deprives private parties of well established contractual rights—rights that would apply in any contract between private citizens—whenever those parties enter into a contract with the government. The Federal Circuit's decision thus will affect not only the approximately 120 *Winstar*-related cases that are currently pending in the lower federal courts, *see Advance Bank, F.S.B. v. United States*, 52 Fed. Cl. 286, 286 (2002), but also untold billions of dollars' worth of other government contracts. In particular, under the decision below, any party that enters a unilateral contract with the government by rendering performance under the contract will be deprived of its right to restitution if the government subsequently fails to fulfill its end of the bargain. Contrary to the principles of restitution, the government

will be unjustly enriched and the non-breaching party left without remedy. In addition, individuals who are clearly intended to be beneficiaries of a contract with the government will, under the Federal Circuit's approach, lose their rights to sue for its breach unless they meet the Federal Circuit's "more stringent" test of being "direct beneficiaries."

The consequences of the uncertainty created by the decision below will be severe. As this Court explained in *Winstar*, contracts that assign to one party the risk of a regulatory change "are especially appropriate in the world of regulated industries, where the risk that legal change will prevent the bargained-for performance is always lurking in the shadows." *Winstar*, 518 U.S. at 869; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 264, cmt. *a* ("With the trend toward greater governmental regulation . . . . parties are increasingly aware of such risks, and a party may undertake a duty that is not discharged by such supervening governmental actions . . . ."). But without the assurance that the ordinary rules of contract construction and breach "applicable to contracts between private individuals," *Lynch*, 292 U.S. at 579, bind the government as well, no rational government contractor will comfortably deal with the government. *See, e.g.*, *Winstar*, 518 U.S. at 910 ("It would, indeed, have been madness for respondents to have engaged in these transactions with no more protection than the Government's reading would have given them . . . ."). Review of the Federal Circuit's refusal to adhere to the RESTATEMENT (SECOND) OF CONTRACTS is therefore warranted.

II. The Federal Circuit's Conclusion That The Government Is Not Required To Pay Just Compensation For Taking Petitioners' Property Warrants This Court's Review

1. In defining the "property" of petitioners for Takings Clause analysis, the court below arbitrarily, and improperly, segmented petitioners' property into two pieces: their contractual rights and their ownership of Western Empire. App., *infra*, 24a-26a. In so doing, the Federal Circuit's holding created a conflict with this Court's case law defining "property" and prohibiting such artificial segmentation of that property for purposes of Takings Clause analysis.

The court below concluded that no property was taken because (1) "seizure of a bank for failure to meet regulatory capital requirements does not constitute a taking" and (2) "plaintiffs retained the full range of remedies associated with any contractual property right they possessed." App., *infra*, 24a, 26a. The court thus considered petitioners' property to consist of two separable elements: Their ownership of the thrift, and their contract with the government. The court refused to acknowledge, much less address, petitioners' contention that these elements were merged into a *unitary* property right that gave rise to a reasonable, investment-backed expectation that the government would not seize the thrift so long as petitioners operated in accordance with the contract (as they did). *See* Pet. C.A. Br. 50-52. The court of appeals' artificial segregation of petitioners' property interests cannot be reconciled with this Court's Takings Clause jurisprudence.

It is well established that, for purposes of Takings Clause analysis, "property" includes: (1) businesses,

see, e.g., *United States v. Pewee Coal Co.*, 341 U.S. 114, 115-17 (1951); *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 630-31 (1952) (Douglas, J., concurring), and (2) contracts, *see, e.g.*, *Lynch v. United States*, 292 U.S. 571, 579 (1934) ("Rights against the United States arising out of contract with it are protected by the Fifth Amendment"); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984). Thus, both aspects of petitioners' property right are protected by the Fifth Amendment. Moreover, where both types of property are involved, this Court has made clear that just compensation is required for the *entire value* of a business, including the physical assets *and* any government contracts specifying how those assets may be operated. *See, e.g.*, *Monongahela Navigation Co. v. United States*, 148 U.S. 312, 327-30 (1893); *Long Island Water Supply Co. v. Brooklyn*, 166 U.S. 685, 690-91 (1897).

In *Monongahela*, this Court held that an owner of a business (locks and dams) had a property interest consisting of the tangible structures of the business combined with a right (pursuant to a government-issued franchise contract) to operate the business in a particular manner—namely, the right to charge tolls. *Monongahela*, 148 U.S. at 327-30. Just compensation, the Court held, must include *both elements*. *See ibid.* As the Court explained, "before this property can be taken away from its owners, the *whole value* must be paid," including both the physical structures and the contractual right to operate those structures in a particular manner. *Id.* at 329 (emphasis added); *see also id.* at 328 ("The value, therefore, is not determined by the mere cost of construction, but more by what the completed structure brings in the way of earnings to its owner").

This Court recognized the same principle in *Long Island Water Supply*, holding that the property of a water company that was taken by the government consisted of its "tangible property" (water hydrants) combined with the company's contract to provide a city with use of those hydrants. *See* 166 U.S. at 690. The Court noted that the contract "is property, and, like any other property may be taken under condemnation proceedings for public use . . . subject to the rule of just compensation," *ibid.*, and explained that "the condemnation proceedings . . . appropriate[d] [the contract], as they d[id] the tangible property of the company, to public uses." *Id.* at 691.

Just last Term, this Court reaffirmed that property should be defined based on "'the parcel as a whole,'" not a piece of the whole. *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 122 S. Ct. 1465, 1483 (2002) (quoting *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 130-131 (1978)). In *Tahoe-Sierra*, this Court refused to sever a segment of property (in that case, a temporal segment) from the whole in defining the relevant property interest for Takings Clause analysis. The Court rejected the petitioners' "conceptual severance" argument "because it ignore[d] *Penn Central's* admonition that in regulatory takings cases we must focus on 'the parcel as a whole.'" *Ibid.* (quoting *Penn Cent.*, 438 U.S. at 130-31). In *Penn Central*, this Court explained that "'Taking' jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated." *Penn Cent.*, 438 U.S. at 130. Rather, the Court focuses on the character of government action and on "the nature and extent of the interference with rights in the parcel as a whole." *Id.*

at 130-31. The decision below, by segmenting petitioners' property interest into two pieces to be analyzed separately, directly contravenes each of these precedents.

2. The court below also erroneously held that petitioners suffered no taking in this case because they "retained the full range of remedies associated with any contractual property right they possessed." App., *infra*, 26a.[5] The court reasoned that "[t]he plaintiffs received no contractual guarantee that the government would refrain from regulating Western Empire. At most, the contract promised either to regulate Western Empire consistently with the contract's terms, or to pay damages for breach." *Ibid.* Thus, the panel concluded: "we hold that even assuming the enactment and enforcement of FIRREA breached a contract the government had with Castle and Harlan, it did not constitute a taking of the contract." *Id.*

Even if the court below were correct that the only "property" at issue was petitioners' contract, the panel's holding with respect to that property conflicts with numerous decisions of this Court that make clear that rights based on contracts with the government are protected by the Fifth Amendment, which requires the

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[5] The court's holding in this regard is particularly ironic in light of the Federal Circuit's evisceration of contract remedies in this and other cases involving *Winstar*-type contracts. Having held, in plain contravention of the RESTATEMENT and prior decisions, that petitioners *cannot* obtain restitution for the government's breach of contract, the Federal Circuit's reasoning that the theoretical *availability* of contract remedies removes this case from the ambit of the Fifth Amendment rings hollow indeed.

payment of just compensation, not merely contract damages. *See, e.g.*, *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984) (holding that an "explicit governmental guarantee" of confidentiality "formed the basis of a reasonable, investment-backed expectation" that the government would keep its promise); *Kaiser Aetna v. United States*, 444 U.S. 164, 179-80 (1979) (holding that a government contract—an implicit governmental promise regarding the use of a body of water—gave rise to an "expectanc[y] . . . that the Government [could not] take without compensation").

Contrary to the panel's decision, under this Court's precedents, the availability of contract remedies neither obviates the government's obligation to pay just compensation nor limits petitioners' reasonable, investment-backed expectations. Thus, in *Lynch v. United States*, 292 U.S. 571 (1934), for example, this Court made clear that the remedy for the taking of a contract is "just compensation":

> The Fifth Amendment commands that property be not taken without making *just compensation*. Valid contracts are property, whether the obligor be a private individual, municipality, a state, or the United States. Rights against the United States arising out of a contract with it are *protected by the Fifth Amendment*.

Id. at 579 (emphasis added). Likewise, in *De Laval Steam Turbine Co. v. United States*, 284 U.S. 61 (1931), this Court explained that a sovereign act canceling a "contract . . . with the government . . . is an exercise of the power of eminent domain, and the *liability of the government is for just compensation*." *Id.* at 71 (emphasis added). "[W]hether the contract requisitioned or

canceled be one with the government or one between private individuals, the person whose property rights are taken or destroyed is *entitled to receive just compensation, not damages* as for a breach." *Id.* at 70 (emphasis added); *see also Monsanto*, 467 U.S. at 1011; *Kaiser Aetna*, 444 U.S. at 179-80. The panel's holding that an individual whose property includes rights secured under contract with the government can *never* have a reasonable, investment-backed expectation that the government will pay just compensation if it seizes the property or wipes out its value through regulation is contradicted by each of these Supreme Court decisions.

The panel's holding that the availability of contract remedies precludes an award of just compensation also conflicts with this Court's precedents requiring the payment of just compensation even if an alternative remedial scheme is in place, so long as the alternative remedy does not amount to just compensation. In *Regional Rail Reorganization Act Cases*, 419 U.S. 102 (1974), for example, this Court held that, if an alternative remedial scheme exists but fails to provide just compensation for a governmental taking, the government must make up the "constitutional shortfall." *Id.* at 155; *see also Monsanto*, 467 U.S. at 1018 n.21; *Williamson County Reg'l Planning Comm'n v. Hamilton Bank of Johnson City*, 473 U.S. 172, 194-95 (1985).[6] In sum, the Federal Circuit's holding denying just compensation in this case,

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[6] Here, the amount of just compensation exceeds the trial court's award of restitution for breach of contract because, among other reasons, the Constitution requires the payment of prejudgment interest. *See, e.g., Library of Congress v. Shaw*, 478 U.S. 310, 317 n.5 (1986).

like its denial of a restitutionary remedy, cannot be reconciled with this Court's precedents.

* * *

More than a decade ago, petitioners Castle and Harlan answered their government's call and rescued a failing thrift with an infusion of $15.12 million in private capital. Although they kept their end of the bargain, the government broke its promises and seized their property. Petitioners have spent twelve years, and millions of dollars, attempting to recover the value of their investment. Law, equity, and fundamental fairness demand that the government at least return the money that petitioners contributed at the government's behest, if not the entire value of their property. "Great nations, like great men, should keep their word." *Federal Power Comm'n v. Tuscarora Indian Nation*, 362 U.S. 99, 142 (1960) (Black, J., dissenting). The decision below, which awards precisely zero for the government's clear breach of contract, is a travesty of justice. Certiorari should be granted to ensure that not only petitioners but all those who do business with the government are assured of a fair remedy in the event of the government's breach. Otherwise, this Court's decision in *Winstar* will itself become an empty promise, because the government's liability for breaching its contracts is meaningless in the absence of appropriate remedies.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

JOHN C. MILLIAN
Counsel of Record
THOMAS G. HUNGAR
MARK A. PERRY
PAUL BLANKENSTEIN
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 955-8500

Counsel for Petitioners

December 16, 2002

APPENDIX

APPENDIX A

United States Court of Appeals for the Federal Circuit

01-5047, -5050

JOHN K. CASTLE, LEONARD M. HARLAN, DONALD C. CARTER, DOUBLE S & M PARTNERSHIP, GRACE & GREEN ARBITRAGE PARTNERS, HUDSON VALLEY PARTNERS, L.P., DAN W. LUFKIN, MCI TWO INVESTMENT LIMITED PARTNERSHIP, ROBERT MARSTON, MCD MERGER ARBITRAGE FUND, LTD., L.T. FOSTER, NORTHERN TRUST CO., TRUST # 2-67917 (KATE T. FOSTER TRUST FBO), R.C. FOSTER, NORTHERN TRUST CO., TRUST # 2-67918 (KATE T. FOSTER TRUST FBO), J.R. FOSTER, NORTHERN TRUST CO., TRUST # 2-67919 (KATE S. THOMPSON TRUST FBO), PUBLIC SERVICE RESOURCES, SOCIETY BANK & TRUST-TRUSTEE, ZANE TANKEL PARTNERS, ROBERT V. DOLAN, M.D., LEO W. KWAN, M.D. PENSION AND PROFIT SHARING TRUSTS, ROBERT B. LYONS, ROBERT MARGOLIS, FOSVEN ASSOCIATES PARTNERSHIP, STANLEY E. ROBERTS, M.D., SANWA BANK OF CALIFORNIA, TRUSTEE, YORBA LINDA MEDICAL GROUP FBO RUSSELL E. EWING, CASTLE HARLAN, INC., and CENWICK FUND,

Plaintiffs-Cross Appellants,

and

FEDERAL DEPOSIT INSURANCE CORPORATION,

Plaintiff-Appellee,

v.

UNITED STATES,

Defendant-Appellant.

John C. Millian, Gibson, Dunn & Crutcher LLP, of Washington, DC, argued for plaintiffs-cross-appellants.

With him on the brief were Mark A. Perry, and Paul Blankenstein.

John V. Thomas, Associate General Counsel, FDIC, of Washington, DC, for plaintiff-appellee. With him on the brief were Thelma Diaz, Stephen Kessler, and Ellis Merritt, Counsels, FDIC.

David M. Cohen, Director, Commercial Litigation Branch, Civil Division, Department of Justice, of Washington, DC, argued for defendant-appellant. With him on the brief were Stuart E. Schiffer, Acting Assistant Attorney General; Jeanne E. Davidson, Deputy Director; Paul G. Freeborne, Michael M. Duclos, Katherine M. Kelly, Kenneth M. Kulak, and Jane M. E. Peterson, Trial Attorneys.

Appealed from: United States Court of Federal Claims Judge John P. Wiese

DECIDED: August 19, 2002

Before LOURIE, RADER, and GAJARSA, Circuit Judges.

GAJARSA, Circuit Judge.

This is a *Winstar*-related case. On cross-motions for summary judgment, the United States Court of Federal Claims ("Court of Federal Claims," or "trial court") held that two of the plaintiffs, John K. Castle ("Castle") and Leonard M. Harlan ("Harlan"), were parties to a contract that the government breached by enacting the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. 101-73, 103 Stat. 183, and its implementing regulations. *Castle v. United States*, 42 Fed. Cl. 859, 861-64 (1999) (Smith, C.J.). Also on these motions, the Court of Federal Claims determined that

the remaining named plaintiffs other than the Federal Deposit Insurance Corporation (the "FDIC") were third-party beneficiaries to the breached contract, and that their third-party beneficiary status afforded them proper standing. *Id.* at 866. After rejecting the argument that Castle and Harlan had committed a prior material breach, the Court of Federal Claims granted summary judgment of liability against the United States for breach of contract. *Id.* at 867.

Following the grant of summary judgment of liability, then-Chief Judge Smith transferred the case to Judge Wiese, who held a trial on damages. *See Castle v. United States*, 48 Fed. Cl. 187, 191 (2000) (Wiese, J.). After a four-month trial, the court awarded the plaintiffs other than the FDIC $15.1 million in damages under a theory of restitution. *Id.* at 220. The trial court held, however, that the passage of FIRREA and its implementing regulations did not effect a taking of the plaintiffs' property pursuant to the Fifth Amendment of the United States Constitution. *Id.* Finally, the Court of Federal Claims determined that the FDIC lacked standing to assert a claim to money damages against the government. *Id.* Accordingly, on November 9, 2000, the court entered final judgment dismissing the FDIC from the case and awarding the remaining plaintiffs $15.1 million in damages. *Castle v. United States,* No. 90-1291 C (Fed. Cl. Nov. 9, 2000) (order entering final judgment).

The United States appeals. It contends that the Court of Federal Claims erred in granting summary judgment of liability for breach of contract as well as in awarding the plaintiffs other than the FDIC $15.1 million in damages on a theory of restitution. The named plaintiffs

other than the FDIC cross-appeal, contending that the Court of Federal Claims erred in holding that the passage and implementation of FIRREA did not effect a taking under the Fifth Amendment, for which they are entitled to just compensation. The FDIC chose not to appeal its dismissal, and is therefore no longer a party to this case.

We conclude that the Court of Federal Claims erred in determining that the plaintiffs other than the FDIC and Castle and Harlan had standing to sue as third-party beneficiaries of the alleged contract. With respect to those plaintiffs, we vacate the Court of Federal Claims' grant of summary judgment of liability, and remand with instructions to dismiss them from the case. With respect to the remaining plaintiffs, Castle and Harlan, we conclude that the Court of Federal Claims correctly determined that the passage and implementation of FIRREA effected no Fifth Amendment taking. We therefore affirm the court's determination in this respect. We conclude, however, that the court erred in awarding the plaintiffs damages for breach of contract. The documents comprising the alleged contract did not require Castle and Harlan to contribute to the recapitalization of Western Empire. Castle and Harlan cannot recover in restitution the amounts they voluntarily contributed, nor do the circumstances of this case entitle them to damages on a theory of reliance. Consequently, we reverse the damages award. We do not decide whether the Court of Federal Claims correctly granted summary judgment of liability.

I. BACKGROUND

As with the other *Winstar*-related cases, this case involves claims against the government stemming from

Congress' enactment of FIRREA in response to the savings and loan crisis of the 1980s. The circumstances surrounding this crisis in the thrift industry are by now familiar; as they are well-documented elsewhere, we do not fully recount them here. *See United States v. Winstar Corp.*, 518 U.S. 839, 843-58 (1996); *Glendale Fed. Bank, FSB v. United States*, 239 F.3d 1374, 1376-78 (Fed. Cir. 2001). Instead, we echo the Court of Federal Claims' succinct explanation of the pertinent facts.

In the 1980s, interest rates rose. This caused a number of savings and loan institutions, or thrifts, to become insolvent when the interest rates they were forced to pay in order to attract new deposits exceeded the income generated from mortgages entered previously at lower rates. *Castle*, 48 Fed. Cl. at 191. The agency that insured thrift deposits, the Federal Savings and Loan Insurance Corporation ("FSLIC"), was threatened with the exhaustion of its insurance funds. *Id.* The agency therefore sought private investors and healthy thrifts to take over ailing thrifts before they failed. *Id.* at 191-92. This was accomplished in a series of "supervisory mergers." *Winstar*, 518 U.S. at 847.

As an incentive to engage in supervisory mergers, government regulators routinely agreed to afford the thrifts particular regulatory treatment. Advantageous accounting treatment of goodwill was foremost among these incentives. *Id.* at 848. Supervisory mergers generated "supervisory goodwill," an amount determined by the difference between an ailing thrift's purchase price and the fair value of its identifiable assets. Although generally accepted accounting principles ("GAAP") do not permit treating goodwill as such, regulators encouraged supervisory mergers by allowing the acquirors of

ailing thrifts to count supervisory goodwill toward the thrift's regulatory capital requirements, and to amortize it over an extended period of time. Such amortization allowed the acquiring institutions to report larger amounts in their regulatory capital reserve accounts than they would have been able to report had they been required to amortize the goodwill over a shorter time period. This allowed the acquiring institutions to satisfy the regulatory capital requirements without obtaining additional capital infusions.

When this approach exacerbated the crisis rather than alleviating it, Congress, on August 9, 1989, enacted FIRREA. Pub. L. 101-73, 103 Stat. 183. FIRREA overhauled the structure of federal thrift regulation. *Winstar*, 518 U.S. at 856. Among other things, it required thrifts to maintain core capital of at least three percent of their total assets, and prohibited counting unidentifiable intangible assets, such as goodwill, toward this capital maintenance requirement. *Id.* (citing 12 U.S.C. §§ 1464(t)(2)(A), 1464(t)(9)(A)).

A number of thrifts that had engaged in supervisory mergers became unable to meet the stricter standards imposed by FIRREA, and were subsequently seized. This spawned the *Winstar* litigation, in which the acquirors of ailing thrifts alleged that by enacting and implementing FIRREA, the government breached contracts promising thrifts particular regulatory treatment and took property without just compensation in violation of the Fifth Amendment. In *Winstar*, the Supreme Court upheld this court's en banc determination that the documents executed between government regulators and the acquiring thrifts in connection with the supervisory

mergers there at issue constituted enforceable agreements. *Id.* at 859-60.

Hundreds of *Winstar*-related cases were initiated in the wake of FIRREA. In addition to *Winstar* itself, this court has reviewed appeals in several other *Winstar*-related cases. *See, e.g.*, *Frazer v. United States*, 288 F.3d 1347 (Fed. Cir. 2002); *Bluebonnet Savs. Bank, F.S.B. v. United States*, 266 F.3d 1348 (Fed. Cir. 2001); *Glass v. United States*, 258 F.3d 1349 (Fed. Cir. 2001), *amended on reh'g* 273 F.3d at 1072 (Fed. Cir. 2001); *California Fed. Bank, FSB v. United States*, 245 F.3d 1342 (Fed. Cir. 2001), *cert. denied*, 122 S. Ct. 920 (2002); *Glendale*, 239 F.3d at 1384; *Caugas Cent. Fed. Savs. Bank v. United States*, 215 F.3d 1304 (Fed. Cir. 2000); *First Hartford Corp. Pension Plan & Trust v. United States*, 194 F.3d 1279 (Fed. Cir. 1999). This is another such case.

In 1988, Western Empire Savings and Loan Association ("Western Empire") was a financially troubled thrift that was seeking an acquiror willing to recapitalize it. Castle and Harlan, who owned a merchant banking firm called Castle Harlan, Inc. ("CHI"), decided to pursue a "thrift project." On June 20, 1988, CHI sent a letter of intent to the board of directors of Western Empire. CHI's letter of intent proposed that CHI would acquire Western Empire by merging it into a new entity. CHI's intent letter also proposed that "[i]n connection with the Merger, capital will be contributed to Western Empire in order to comply with applicable regulatory requirements," by contributing capital to the new merger entity "and, as a result of the Merger, to Western Empire."

On November 4, 1988, Castle and Harlan submitted a "Notice of Change of Control of Western Empire Sav-

ings and Loan Association" to the Federal Home Loan Bank Board ("Bank Board"). As an attachment to this notice, Castle and Harlan submitted a business plan on Form 1173 as the regulations required ("the Business Plan"). *See* 12 C.F.R. § 574.6(a) (1988). The Business Plan was nontraditional; among other things, it included investment in high yield bonds. Castle and Harlan's notice also included "Requests for Forbearances, Approvals, Waivers and Certifications," as a "condition precedent" to the obligation to effect the merger.

On December 30, 1988, the Bank Board sent Castle and Harlan an approval letter "subject to the conditions and forbearances" set forth in the attached Conditions for Approval ("Conditions"). One of the conditions required that "[o]n behalf of New Western Empire the Board of Directors shall execute a Regulatory Capital Maintenance Agreement that sets forth the terms of the minimum acceptable level of Tangible Capital and the consequences of failure to meet such requirement."

That same day, the Regulatory Capital Maintenance Agreement ("RCMA" or, as it is self-styled in the alternative, colloquially, the "Pre Nuptial Agreement") was executed. The first paragraph of the RCMA recites:

> THIS AGREEMENT, dated December 30, 1988, is entered into by and among Western Empire Savings and Loan Association, as the entity exists following the merger of WESL Merger Corp. and Western Empire Savings and Loan Association, a California chartered stock savings bank ("New Western Empire"); John K. Castle and Leonard M. Harlan (collectively, "Acquirors"); and the Federal Savings and Loan Insurance Corporation, a corporate instru-

mentality of the United States ("FSLIC" or "Corporation").

Castle and Harlan signed the RCMA, although on appeal the parties dispute whether they did so in their individual capacities or as representatives of Western Empire. The FSLIC signed the RCMA by its supervising agent, and Western Empire also signed, by its president and chief executive officer.

According to the plaintiffs, these documents—the business plan, the approval letter with attached Conditions, and the RCMA—memorialize the alleged "contract." Castle and Harlan contend that, pursuant to this contract, they agreed to acquire and recapitalize Western Empire, and that, in exchange, the Bank Board and FSLIC promised to afford Western Empire special regulatory treatment.

The business plan called for an infusion of "as much as $26 million," to recapitalize Western Empire, "but in no case will it be less than the amount necessary to capitalize the existing assets at the required rate." Upon the signing of the RCMA, Castle and Harlan contributed $500,000 into Western Empire. The other shareholder-plaintiffs contributed an additional $14.6 million. This total of $15.1 million is the consideration the plaintiffs allege they contributed in support of the contract. This amount also formed the basis for the Court of Federal Claims' restitution award.

Congress enacted FIRREA in August 1989, approximately eight months after Castle and Harlan began operating Western Empire. *Castle*, 48 Fed. Cl. at 192. From the outset, Western Empire's performance "lagged behind the projections set forth in the business plan."

Id. (noting that commercial real estate properties were more costly and difficult to dispose of than had been anticipated, mortgage-origination rates fell short of predictions, and long-term deposits, which were the initially-proposed funding source for high yield bonds, were unobtainable).

"Due in part to these initial difficulties," in September of 1989, the Office of Thrift Supervision ("OTS") informed Western Empire that it had fallen out of tangible capital compliance, and that, pursuant to its agreement, it had 90 days to cure the deficiency. *Id.* In response, Western Empire attempted to remedy its capital deficiency by shrinking its asset base. *Id.* This allowed Western Empire to meet the minimum capital maintenance required under its alleged contract—two percent of total liabilities—without raising additional capital. *Id.* FIRREA, however, required more stringent capital maintenance.

By letter dated October 23, 1989, OTS informed Western Empire that its original business plan was "no longer practicable in the wake of the passage of [FIRREA]." In February of 1990, OTS placed Western Empire into receivership for failure to comply with the capital maintenance requirements imposed by FIRREA.

On September 25, 1990, Castle, Harlan, and the other named plaintiffs[1] filed suit in the Court of Federal Claims. They alleged that the passage of FIRREA and its implementing regulations breached four contractual

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[1] These plaintiffs are either shareholders or subordinated debt holders of Western Empire (the "shareholder-plaintiffs").

promises and effected a taking of their property (the alleged contract) for which the Fifth Amendment requires the government to pay just compensation.[2] The four promises allegedly breached by the passage of FIRREA were that: 1) for five years, Western Empire would be permitted to meet the lesser of the capital requirements imposed by regulation or the modified capital requirement set forth in the Conditions; 2) Western Empire could include supervisory goodwill in the calculation of its regulatory capital, and could amortize it over a period of not more than twenty years; 3) Western Empire could invest up to twenty-five percent of its assets in high yield bonds for the first six months, and up to thirty-five percent of its assets in such bonds thereafter, and 4) for two years, Western Empire would not be subject to the normal liability growth restrictions imposed by regulations.

The parties submitted cross-motions for partial summary judgment regarding liability, and the United States submitted a partial motion to dismiss certain plaintiffs. The Court of Federal Claims granted the plaintiffs' motion on liability. *Castle*, 42 Fed. Cl. at 859. The court held that Castle, Harlan, the Bank Board, and FSLIC were parties to a contract memorialized in the business plan, the approval letter including the Conditions, and the RCMA. *Id.* at 861. The Court of Federal Claims also held that the shareholder-

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[2] The FDIC, as the receiver for Western Empire, intervened, but the Court of Federal Claims dismissed it for lack of standing. *See Castle et al. & Fed. Deposit Ins. Corp. v. United States*, No. 90-1291 C (Fed. Cl. Nov. 9, 2000) (order dismissing the FDIC). The FDIC did not appeal its dismissal.

plaintiffs other than Castle and Harlan were third-party beneficiaries of this contract and that, consequently, they had standing to sue for its breach. *Id.* at 866. On the merits, the court agreed with the plaintiffs that the Congressional enactment of FIRREA and the promulgation of its implementing regulations breached critical components of the contract. *Id.* at 860. The court rejected the government's arguments that § 7(c) of the RCMA placed the risk of a change upon the shareholders, and that the plaintiffs had committed a prior material breach. *Id.* at 862-64, 866-67. Based upon these conclusions, the court granted the plaintiffs' motions for summary judgment of liability for breach of contract. *Id.* at 867.

Pursuant to the applicable case management orders, then-Chief Judge Smith, who had previously presided over the case, transferred the case to Judge Wiese for all further proceedings. *Id.* at 867. Before Judge Wiese, the parties conducted a four-month trial on damages. After trial, the Court of Federal Claims held that the shareholder-plaintiffs were entitled to recover as restitution their entire initial investment in Western Empire: $15.1 million. *Castle*, 48 Fed. Cl. at 216. The court also held that the passage of FIRREA did not effect a taking. *Id.* at 220. Judge Wiese entered an order of final judgment on November 9, 2000. *Castle*, No. 90-1291 C (Fed. Cl. Nov. 9, 2000) (order entering final judgment).

On February 12, 1999, the government had filed a motion for clarification of unresolved issues remaining in the wake of Judge Smith's opinion concerning liability. In this motion, the government argued that it had never conceded the existence of a *Winstar*-type contract, and requested clarification of the documents constituting the alleged contract and of the contract's duration. On

December 4, 2000, Judge Smith denied the motion for clarification as moot in view of Judge Wiese's November 9, 2000, order entering final judgment. *See Castle v. United States*, No 90-1291 C (Fed. Cl. Dec. 4, 2000) (order denying motion for clarification).

The government appeals. On appeal, it challenges the Court of Federal Claims' grant of summary judgment of liability for breach of contract, as well as its award of damages. With regard to liability, the government advances the following five arguments: 1) no *Winstar*-like contract existed, 2) the plaintiffs, who are merely shareholders of Western Empire, lack standing, 3) if there was a contract, the RCMA shifted the risk of regulatory change to the plaintiffs, and therefore enacting FIRREA resulted in no breach, 4) even if enacting FIRREA would otherwise constitute a breach, any such breach is excused by a prior material breach committed by the plaintiffs, and 5) any breach that did occur by the government caused no injury. The United States also contends that the award of restitution was improper and that, at most, the plaintiffs are entitled to reliance damages reduced by their losses.

The remaining plaintiffs cross-appeal. They contend that the Court of Federal Claims erred in holding that the government did not effect a Fifth Amendment taking of their property by enacting FIRREA. Thus, they contend, they are entitled to an award of just compensation in addition to the award of damages for breach of contract.

II. STANDARD OF REVIEW

Summary judgment is appropriate only if there is no genuine issue of material fact and the moving party is entitled to a judgment as a matter of law. Fed. R. Civ.

Pro. 56(c); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986). This court reviews a grant of summary judgment by the Court of Federal Claims *de novo* to determine whether it correctly applied this standard. *California Fed. Bank*, 245 F.3d at 1346 (citing *Winstar Corp. v. United States*, 64 F.3d 1531, 14539 (Fed. Cir. 1995) (en banc) (citing *Liberty Lobby*, 477 U.S. at 255; *Southfork Sys., Inc. v. United States*, 141 F.3d 1124, 1131 (Fed. Cir. 1998)), *aff'd*, *United States v. Winstar Corp.*, 518 U.S. 839 (1996)).

The existence or non-existence of a contract is a mixed question of law and fact. *Id.* Contract interpretation is a question of law, reviewed *de novo*. *Id.*

Whether a plaintiff has standing to bring suit is likewise a question of law, reviewed *de novo*. *Consol. Edison Co. v. Richardson*, 233 F.3d 1376, 1379 (Fed. Cir. 2000). Standing is a threshold jurisdictional issue, which implicates Article III of the Constitution and therefore may be decided without addressing the merits of a determination. *Myers Investigative and Security Servs., Inc. v. United States*, 275 F.3d 1366, 1369 (Fed. Cir. 2002) (citing *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 102-04 (1998); *Arizonans for Official English v. Arizona*, 520 U.S. 43, 66-67 (1997)).

III. DISCUSSION

We conclude that only Castle and Harlan have standing to sue for breach of the alleged contract because only Castle and Harlan signed any document constituting the alleged contract. The remaining shareholders are not parties. They also lack standing to sue as third-party beneficiaries because their sole benefit under the alleged contract was in their capacity as shareholders of Western

Empire. Therefore, we vacate the Court of Federal Claims' determinations with respect to the shareholder plaintiffs other than Castle and Harlan, and remand with instructions to dismiss them from the case.

Although Castle and Harlan have standing to sue for breach of the alleged contract, we conclude that they are entitled to no damages. Because we find that Castle and Harlan have not established their entitlement to damages, we need not determine whether the Court of Federal Claims erred in granting summary judgment of liability, which it did, in part, based on a concession regarding the existence of a contract—a concession the government contends was never made. Accordingly, we reverse the damages award and expressly decline to consider the liability issue.

Finally, we conclude that the Court of Federal Claims correctly held that the enactment of FIRREA effected no taking. We therefore affirm that portion of its judgment.

A. Standing

The Court of Federal Claims determined that the plaintiffs other than Castle and Harlan were third-party beneficiaries of a contract between Castle, Harlan, the FSLIC, and the Bank Board. The court reached this conclusion by applying the approach to third-party beneficiary status adopted by the Ninth Circuit in *Far West Federal Bank, S.B. v. Office of Thrift Supervision*, 119 F.3d 1358 (9th Cir. 1997). In *Far West*, the Ninth Circuit determined that the "nature and circumstances" of the supervisory merger at issue in that case demonstrated that the investor plaintiffs were third-party beneficiaries because they were intended beneficiaries of the

Bank Board's promises to afford the acquired thrift particular regulatory treatment. *Far West*, 119 F.3d at 1363-64. Applying this logic, the Court of Federal Claims reasoned that:

> The court believes that these investor plaintiffs are not parties, but are third party beneficiaries of the contract. This is clear after a quick review of the nature and circumstances of the transaction. The parties to the transaction were Messrs. Castle and Harlan, the [Bank Board] and the FSLIC. The very purpose of the contract, however, as clearly spelled out in the Business Plan of Castle Harlan (and in essence undisputed by the government), was to enshrine a modified regulatory regime under which Western Empire would operate that would induce investors to recapitalize the thrift. The capital these investors would provide was the linchpin of the agreement, not the nominal $2000 Messrs[.] Castle and Harlan paid for the value of the common stock. It was for the investors' benefit, to induce their investments, that the government made its promises.

Castle, 42 Fed. Cl. at 866. Consequently, the court determined that the plaintiffs other than Castle and Harlan had standing as third-party beneficiaries to bring a claim alleging breach of contract. The court came to this conclusion, however, without the benefit of our decision in *Glass v. United States*, 258 F.3d 1349 (Fed. Cir. 2001).

In *Glass*, this court adopted a test more stringent than the one applied in *Far West*. We held that shareholders seeking status to sue as third-party beneficiaries of an allegedly breached contract must "demonstrate that the

contract not only reflects the express or implied intention to benefit the party, but that it reflects an intention to benefit the party *directly*." *Glass*, 258 F.3d at 1354 (emphasis added). We explained that "[s]pecifically, in order to make a shareholder a third party beneficiary, the contract must express the intent of the promissor to benefit the shareholder *personally, independently of his or her status as a shareholder*." *Id.* at 1353-54 (emphasis added).

The plaintiffs other than Castle and Harlan cannot satisfy this standard. Under the alleged contract, every promise the government failed to keep in the wake of FIRREA pertains to the regulatory treatment of Western Empire. Nothing suggests that the government made any promises, contractual or otherwise, that were expressly intended to benefit the shareholders personally, independently of their status as shareholders of Western Empire. Indeed, as the Court of Federal Claims observed in rejecting the shareholder-plaintiffs' right to seek lost profits:

> The contract performance that was promised was the granting of special regulatory forbearances which the government agreed to extend to the bank. And while plaintiffs could, of course, expect to benefit from that performance as the value of the bank grew, they held no rights to that performance for themselves.

Castle, 48 Fed. Cl. at 199. It was only through their status as shareholders that these plaintiffs stood to benefit from the alleged contract. *See id.* (The plaintiffs other than Castle and Harlan "cannot claim more than they had in the first instance: a right to a benefit that can only come to them *through* the bank."). Consequently,

these plaintiffs cannot meet the test for third-party beneficiary status articulated in *Glass*, because none of the government's alleged contractual promises conferred benefits upon them personally, apart from their status as shareholders of Western Empire.

Although the plaintiffs attempt to distinguish *Glass* on the basis that the plaintiffs other than Castle and Harlan are non-signatory parties, rather than third-party beneficiaries, this attempt is unavailing. The Court of Federal Claims expressly rejected the proposition that the plaintiffs other than Castle and Harlan were actual parties rather than third-party beneficiaries. *Castle*, 42 Fed. Cl. at 866 ("The court believes that these investor plaintiffs are not parties, but are third party beneficiaries of the contract."). We see no reason to disturb the court's finding that the shareholders other than Castle and Harlan were not parties. The finding is well-supported, because the plaintiffs other than Castle and Harlan neither negotiated with, nor promised any performance to, the government. Nor did the government make any alleged promises to these shareholders. Thus, under *Glass*, these plaintiffs are at most incidental beneficiaries. 258 F.3d at 1354-55. As such, they lack standing to sue for breach of the alleged contract. *Id.*

We have considered the plaintiffs' remaining attempts to distinguish *Glass* and find them to lack merit. Accordingly, we reverse the Court of Federal Claims' determination that the shareholders other than Castle and Harlan have standing to sue as third-party beneficiaries of the alleged contract. We vacate the grant of summary judgment of liability with respect to these plaintiffs, and remand with instructions to dismiss them from the case.

The government also argues that Castle and Harlan are no different than the other plaintiffs, and that they likewise lack standing. This argument is premised on the contention that Castle and Harlan signed the RCMA not in their individual capacities, but as representatives of Western Empire. We reject this premise. Castle and Harlan signed the RCMA as individuals, not as representatives of any entity. In contrast, Western Empire signed the RCMA by its president and CEO, as the face of the agreement makes plain. In fact, while the matter was pending before then-Chief Judge Smith, even the United States recognized that "Castle and Harlan *as individuals*" signed the RCMA. *See* Defendant's Proposed Findings of Uncontroverted Fact at 3-4 (emphasis added).

The RCMA is the main document comprising the alleged contract. *See Castle*, 48 Fed. Cl. at 199 (referring to the RCMA as "the basic contract document"). Castle and Harlan signed the RCMA in their individual capacities. They are direct parties to the RCMA. We therefore hold that Castle and Harlan have standing to allege breach of contract based upon the RCMA and the documents it allegedly incorporates: the Business Plan, and the approval letter with attached Conditions.

B. Breach of Contract

We determine that Castle and Harlan are not entitled to damages due to the alleged breach of contract. This determination renders it unnecessary to examine whether the Court of Federal Claims erred in granting summary judgment of government liability for breach of contract. We expressly decline to reach that issue.

Castle and Harlan contend that in exchange for the government's promise to afford Western Empire particular regulatory treatment, they promised to recapitalize Western Empire. *See* Appellees/Cross Appellants Br., at 3-4 ("[T]he parties finalized a deal under which plaintiffs would recapitalize [Western Empire] with private capital, at no cost to the government, but to the government's great financial benefit."); Wages Decl., ¶ 7 ("As set forth in the Business Plan, the parties agreed that the consideration the government wanted—plaintiffs' money—would be provided by having the Investors purchase preferred stock and subordinated debt for cash that would go into Western Empire. . . ."). According to Castle and Harlan, they were individually liable for the $15.1 million initially contributed by the shareholders to recapitalize Western Empire. They seek this amount in restitutionary damages for the government's breach.

The documents comprising the alleged contract, however, including the Business Plan, contain no promise by Castle and Harlan to recapitalize Western Empire in their individual capacities. They were not individually contractually obligated to contribute capital to Western Empire.

The Business Plan reveals the limited nature of Castle and Harlan's obligations. It states:

> John K. Castle and Leonard M. Harlan as individuals will form a new entity ("New Western Empire") into which the present Association ("Old Western Empire") will be merged. New Western Empire will issue up to $10 million of perpetual Senior Preferred Stock to an investor group *organized by Castle Harlan, Inc.* in order

> to recapitalize the association. . . . The total capital infusion could be as much as $26 million, but in no case will it be less than the amount necessary to capitalize the existing assets at the required rate.

Business Plan, at 4 (emphasis added).

The RCMA—which Castle and Harlan characterize as the basic contractual document—confirms that neither plaintiff promised to be individually responsible for ensuring that Western Empire was adequately capitalized. The RCMA provides that:

> New Western Empire shall maintain the Tangible Capital of New Western Empire at or in excess of two percent (2%) of Total Liabilities. *Acquirors* [Castle and Harlan], *individually, have not agreed to maintain the Tangible Capital of New Western Empire.*

RCMA at § 2(g) (emphasis added).

Thus, although Castle and Harlan signed the RCMA as individuals, they incurred no individual financial liability. Our precedent makes clear that Castle and Harlan cannot recover restitutionary damages in any amount contributed voluntarily, beyond their contractual obligations. *See Landmark*, 256 F.3d at 1372-77 (limiting restitutionary damages for breach of *Winstar*-related contract to capital contributions that were contractually required). In *Landmark*, this court affirmed the Court of Federal Claims' award of damages in the amount of the initial $20 million contribution the plaintiff made to the acquired thrift, a contribution which was expressly required by the contract. *Id.* at 1372-73. The plaintiff also sought to recover a subsequent contribution, which was

not required by the contract. *Id.* at 1374. This court denied recovery for that voluntary contribution, stating, "[t]he law is well settled, however, that in order to be compensable as restitution, the plaintiff's contribution must have been made in performance of its contractual obligations." *Id.* at 1375 (citing *Tangfeldt Wood Prods., Inc. v. United States*, 733 F.2d 1574, 1577 (Fed. Cir. 1984)). The *Landmark* court expressly rejected the argument that restitution was due for contributions made in the spirit of performance under the contract. *Id.* Thus, *Landmark* directly forecloses Castle and Harlan's entitlement to restitutionary damages.

Castle and Harlan also contend that the $15.12 million damages award is justified under the reliance theory of damages. This argument also fails. As we have previously explained, Castle and Harlan are the only parties who have standing to allege that they suffered injury from the alleged breach of contract. The other shareholder-plaintiffs cannot accomplish indirectly what they may not do directly; thus, Castle and Harlan lack standing to assert any reliance interest on behalf of the other shareholders. *Cf. Glass*, 258 F.3d at 1353-54 (holding that shareholders lack standing to sue as third-party beneficiaries to allegedly breached contract unless the contract indicates the intent to benefit them directly, independently of their shareholder status). Consequently, Castle and Harlan are not entitled to recover any of the amount the other shareholder-plaintiffs contributed to Western Empire.

Moreover, Castle and Harlan are not entitled to reliance damages in the amount they contributed individually. "The purpose of reliance damages is to compensate the plaintiff 'for loss caused by reliance on the con-

tract.'" *Landmark*, 256 F.3d at 1379 (quoting Restatement (Second) of Contracts § 344(b)). Castle and Harlan have demonstrated no individual loss that was caused by reliance on the contract. The greatest amount Castle and Harlan purport to have contributed to Western Empire individually is $500,000 for preferred stock, and a concededly nominal $2000 for common stock. Castle and Harlan cannot claim to have lost this amount in reliance on the government's performance of the alleged contract because, as the Court of Federal Claims explained:

> [W]ithout a capital infusion in January 1990, Western Empire would have fallen out of capital compliance and been subject to seizure. . . . A key component of plaintiffs' damages models, then, turns on the court's willingness to accept the premise that plaintiffs would have invested an additional $10 million to keep Western Empire afloat.

Castle, 48 Fed. Cl. at 202. Absent an infusion of an additional $10 million, Western Empire would have fallen out of capital compliance, thereby committing a material breach of the RCMA prior to the enactment of FIRREA. Because Castle and Harlan would have had to contribute substantially more than the amount they now claim in reliance, the government's alleged breach cannot be said to have caused the loss of Castle and Harlan's reliance interest. The absence of a causal link between the alleged breach and the loss Castle and Harlan purport to have contributed in reliance precludes recovery of their individual contributions to Western Empire under a reliance theory of damages.

We therefore hold that Castle and Harlan may not recover damages for the government's alleged breach of contract. Because we find that Castle and Harlan are entitled to no damages, we decline to reach the issue of whether the Court of Federal Claims properly granted summary judgment of government liability for the alleged breach.

C. Fifth Amendment Taking

We affirm the Court of Federal Claims' determination that by enacting FIRREA the government did not take the plaintiffs' property. The property allegedly taken was the plaintiffs' contract, by way of the alleged breach that occurred upon the enactment of FIRREA. The takings claim also fails.

First, the Court of Federal Claims determined that there was "no reason to contemplate a taking that does not involve the taking of contract rights," because seizure of a bank for failure to meet regulatory capital requirements does not constitute a taking. *Castle*, 48 Fed. Cl. at 220 (citing *Branch v. United States*, 69 F.3d 1571, 1575 (Fed. Cir. 1995)). We agree that the seizure of Western Empire for failure to comply with the regulatory requirements imposed by FIRREA did not constitute a taking.

The Court of Federal Claims also determined that FIRREA did not effect a taking of Castle and Harlan's contract notwithstanding its holding that the government was liable for breaching the contract. *Id.* at 217-20. The court held that despite breaching the contract, the government did not take the plaintiffs' property because they retained "the range of remedies associated with the vindication of a contract." *Id.* at 219. In their cross-

appeal, Castle and Harlan dispute this conclusion. They contend that the Fifth Amendment entitles them to just compensation beyond damages for breach of contract. We disagree.

The breach-of-contract based takings claim fails because even assuming it was breached, the alleged contract did not create a reasonable expectation that the government would cease regulating the thrift industry, or any particular thrift therein. As the Supreme Court noted in *Winstar*:

> "[b]anking is one of the longest regulated and most closely supervised of public callings." That is particularly true of the savings and loan, or "thrift," industry, which has been described as "a federally-conceived and assisted system to provide citizens with affordable housing funds." H.R. Rep. No. 101-54, pt. 1, p.292 (1989) U.S. Code Cong. & Admin. News 1989, pp. 86, 88 (House Report).

518 U.S. at 844 (quoting *Fahey v. Mallonee*, 332 U.S. 245, 250 (1947)). In fact, by its terms, the RCMA contemplated that the regulations applicable to Western Empire were subject to change. Section 7(c) of the RCMA provides:

> All references to regulations of the Bank Board or the FSLIC used in this Agreement shall include any successor regulation thereto, *it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease the Acquiror's obligation under this Agreement.*

(Emphasis added).

The plaintiffs received no contractual guarantee that the government would refrain from regulating Western Empire. At most, the contract promised either to regulate Western Empire consistently with the contract's terms, or to pay damages for breach. *Cf. Winstar*, 518 U.S. at 919 (Scalia, J., concurring in judgment) ("Virtually *every* contract operates, not as a guarantee of particular future conduct, but as an assumption of liability in the event of nonperformance. . . ."). Thus, by enacting FIRREA, the government did not deprive the plaintiffs from a contractual remedy—injunctive relief—to which they otherwise might have been entitled against a private defendant. Nor did FIRREA remove the plaintiffs' cause of action for damages. We agree with the Court of Federal Claims that the plaintiffs retained the full range of remedies associated with any contractual property right they possessed. Consequently, we hold that even assuming the enactment and enforcement of FIRREA breached a contract the government had with Castle and Harlan, it did not constitute a taking of the contract. We therefore affirm the Court of Claims' determination that the government owes the plaintiffs no just compensation.

IV. CONCLUSION

We conclude that the plaintiffs other than Castle and Harlan lack standing, and we therefore vacate the grant of summary judgment of liability with respect to these plaintiffs and remand with instructions to dismiss them from the case. We further hold that Castle and Harlan are entitled to no damages for the alleged breach of contract, and that the enactment and enforcement of FIRREA did not effect a taking. Consequently, we affirm the Court of Federal Claims' denial of plaintiffs' claim

for just compensation under the Fifth Amendment, and we reverse the Court of Federal Claims' award of restitutionary damages.

VACATED and REMANDED-IN-PART, AFFIRMED-IN-PART, and REVERSED-IN-PART.

No costs.

APPENDIX B

In the
United States Court of Federal Claims

John K. CASTLE, *et al.*,

Plaintiffs

and

Federal Deposit Insurance Corporation, as Successor to the Rights of Western Empire Savings and Loan Association,

Plaintiff Intervenor,

v.

The UNITED STATES,

Defendant.

No. 90-1291 C

United States Court of Federal Claims

November 9, 2000

Reissued for Publication Dec. 5, 2000

Order Denying Reconsideration
Nov. 30, 2000

Wiese, Judge:

INTRODUCTION

This case comes before the court as one of more than a hundred pending suits known collectively as the *Winstar* litigation, each involving an agreement executed in the late 1980s between a savings and loan institution (a "thrift") and the federal government. In *United States v. Winstar Corp.*, 518 U.S. 839 (1996), the Supreme Court ruled that Congress's passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in various sections of 12 U.S.C.), had the effect of breaching the Winstar Corporation's contract with the government by, among other things, withdrawing the assurances of special regulatory treatment that the corporation had received from federal regulators as part of its contract for the takeover of a failed thrift.

The ruling in *Winstar* was subsequently extended to this case in a decision on cross-motions for summary judgment entered by Chief Judge Smith on February 2, 1999. *Castle v. United States*, 42 Fed. Cl. 859 (1999). Following that decision on liability, the case was transferred to the undersigned judge for the conducting of all further proceedings, including the determination of damages. Based on the testimony developed during the course of a lengthy trial, the court now concludes that plaintiffs are entitled to an award in restitution of $15,122,360.

FACTS

This case arises out of the savings and loan crisis of the late 1980s, a more complete discussion of which can be found in *United States v. Winstar Corp.*, 518 U.S. 839, 844-848 (1996). For our purposes, it is sufficient to

note that rising interest rates in the latter years of that decade caused the insolvency of a number of savings and loan institutions, as short-term costs for attracting new deposits far exceeded the income being earned on earlier-generated mortgages. As the insurer of thrift deposits, the Federal Savings and Loan Insurance Corporation (FSLIC) was thus faced with the likelihood of having to liquidate hundreds of failing thrifts at a cost well in excess of that agency's then-existing funding capability. In an effort to avoid bankruptcy of the insurance fund, FSLIC therefore entered into a series of contracts with both private investors and healthy thrifts, encouraging them to assume responsibility for the ailing institutions. These agreements-and their subsequent breach by FIRREA-now form the basis for the *Winstar* litigation.

It was against this background that Western Empire Savings and Loan Association ("Western Empire" or "the bank"), a two-branch savings and loan located in Irvine, California, found itself financially insolvent in late 1988. Attempts to find a buyer and shore up its capital base eventually led Western Empire into discussions with Castle Harlan, Inc. ("Castle Harlan"), a privately owned investment banking firm that was interested in acquiring a troubled thrift as a vehicle through which to invest in high-yield bonds (also known as "junk bonds"). After several months of negotiations with government regulators, Castle Harlan, acting on behalf of the 22 investors who became shareholders in the successor bank and who appear as plaintiffs in the present litigation, agreed to infuse Western Empire with

up to $25 million in new capital in exchange for certain regulatory forbearances.[1]

The resulting contract-entered into in December 1988 and signed by the regulators, Castle Harlan, and the bank-promised special regulatory treatment to the bank in exchange for the takeover and recapitalization of the insolvent thrift.[2] As part of that agreement, Castle

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[1] In lieu of the $25 million in capital originally contemplated by the business plan, the bank began operations with only $12.5 million in equity (stock) and an additional $2.5 million in subordinated debt (bonds). Castle Harlan did expect, however, to attract the balance of the initially envisioned funding in the early months of 1989.

[2] Essentially four promises made up the essence of the government's commitment:

First, the contract specified that for a period of five years, the bank would be permitted to meet the lesser of either the standard regulatory capital requirements, or the "Modified Regulatory Capital" requirement set forth in the contract documents. The bank would additionally be subject to a two percent "Tangible Capital" requirement which, if not met, would trigger a 90-day cure period in which the bank would be required to return to capital compliance or be subject to seizure.

Second, the contract provided that goodwill would be determined in accordance with purchase method accounting and could be amortized over a period of 20 years. The bank was also permitted to include goodwill, as well as preferred stock and subordinated debt, in its regulatory capital base.

Third, the contract authorized the bank to invest up to 25% of its total assets in high-yield bonds during the first six months of operation, and up to 35% of its assets in high-yield bonds thereafter. Because the bonds were to be held for in-

[Footnote continued on next page]

Harlan submitted a business plan whose operating strategy was relatively straightforward: investments in high yield bonds (to take advantage of the spread between the bank's cost of funds and the yield from the bonds), supplemented by more traditional thrift functions such as residential mortgage originations and investments in mortgage-backed securities.

From the beginning, however, the bank's performance lagged behind the projections set forth in the business plan. Commercial real estate properties—acquired as the result of loan foreclosures—proved more costly and difficult to dispose of than anticipated; mortgage-origination rates fell short of those predicted, and long-term deposits—the initially-proposed funding source for the bank's high-yield bonds—proved unobtainable. Due in part to these initial difficulties, the Office of Thrift Supervision informed the bank's management in September 1989 that the bank had fallen out of tangible capital compliance (the requirement that the capital level be maintained at a minimum of 2% of total liabilities) and that, by the terms of its contract, it had 90 days in which to cure the deficiency. In response to this capital shortfall, Western Empire's management elected to

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[Footnote continued from previous page]
vestment, it was understood that, under generally accepted accounting principles, the bank would be permitted to carry the high-yield bonds on its books at historical cost rather than the lower of cost or market ("LOCOM") as required when securities are "held for sale."

Fourth, the contract exempted the bank from regulatory liability growth limitations for a period of two years in order to allow the bank to increase its assets more quickly and thus to generate greater income.

shrink the bank's asset base, thus remedying its capital deficiency without having to face the necessity of raising additional capital.

On August 8, 1989, roughly eight months after Castle Harlan had commenced operation of the bank, FIRREA was enacted. Although plaintiffs initially believed that the regulators would be willing to strike a balance between the enforcement of FIRREA and the preservation of the essential components of the bank's business plan, that belief was short-lived.

In a letter dated October 23, 1989, the bank was advised by the regulators that its original business plan was "no longer practicable in the wake of the passage of [FIRREA]." The bank was instructed to sell off its high-yield bond portfolio and to come into compliance with the capital requirements introduced by FIRREA. Faced with this drastic revision of their business plan—the cornerstone of which was the ability to invest in and hold high-yield bonds—plaintiffs met in January 1990 to discuss alternatives for keeping the bank afloat. Having consulted with the original investors, each of whom expressed interest in contributing additional funds under "appropriate circumstances," Castle Harlan approached the regulators with a proposal to "spin off" the bond portfolio (*i.e.*, to restructure the portfolio as a separate, collateralized bond undertaking), and to replace these divested assets with cash and a promissory note. The regulators rejected this proposal.

In February 1990, the bank, having failed to achieve compliance with the new capital requirements imposed by FIRREA, was seized by regulatory authorities.

Plaintiffs filed suit in this court on September 25, 1990. In their complaint, plaintiffs contend that the enactment and implementation of FIRREA, combined with the subsequent seizure of the bank, constitute a breach of contract that entitles them either to an award of damages or to restitution. Plaintiffs also maintain, as an alternative to their contract-based claims, that the government's actions amount to a deprivation of their property rights for which they are owed just compensation under the Takings Clause of the Fifth Amendment.

The court has been asked to rule on each of plaintiffs' claims for monetary relief in order to minimize the possible need for a retrial following an appeal. We honor this request. By addressing, in the alternative, all of plaintiffs' theories of recovery, we hope not only to reduce the likelihood of future litigation in this action, but perhaps also to extend the usefulness of the opinion to other Winstar suits still awaiting resolution.

DISCUSSION

PART I

Before considering the case on its merits, we turn first to the various challenges raised by defendant in opposition to both the FDIC and the shareholder-plaintiffs' rights to pursue their claims in this court. Specifically, defendant maintains that the FDIC may not participate in this litigation because its motion to intervene was untimely, that the FDIC's prosecution of the present action is impermissible as it amounts to a suit by the government against itself, and that the bank, rather than the shareholder-plaintiffs, alone may pursue a claim for lost profits. We examine these contentions in turn.

The Timeliness of the FDIC's Intervention

As mentioned above, the shareholder-plaintiffs first filed suit in this court on September 25, 1990. The FDIC, however, did not seek to intervene in this case until March 14, 1997—more than six years after the potential accrual date for *Winstar*-related contract claims recognized by the Federal Circuit's decision in *Ariadne Fin. Servs. Pty. Ltd. v. United States*, 133 F.3d 874 (Fed. Cir. 1998). That delay, in defendant's view, means that the FDIC is now barred under this court's six-year limitations period, 28 U.S.C. § 2501 (1994), from litigating its claim.

In response, the FDIC asserts that a tolling agreement reached between its predecessor and the government effectively suspends the running of the limitations period, so that its intervention under the agreement is timely. In the alternative, the FDIC argues that as the real party in interest, it may join the shareholder-plaintiffs' earlier-filed action, with its intervention relating back to the date of the original complaint. Of these arguments, we conclude that only the second has merit.

In describing its tolling agreement with the government, the FDIC explains that its statutory predecessor, the Resolution Trust Corporation ("RTC"), had entered into an agreement with the Department of Justice purporting to toll the running of the statute of limitations with respect to certain claims, referred to as the "Goodwill Claims," arising out of the contract breaches precipitated by the enactment of FIRREA. The FDIC maintains that under the terms of this agreement, the RTC (and now the FDIC) was granted a period of 130 days following the entry of a final judgment in the *Winstar* case in which to decide whether to initiate litigation

as receiver for the failed thrift institutions. Since that cut-off date has not yet arrived, the FDIC insists that its joinder here in 1997 was timely.

The difficulty with the FDIC's argument is that it presumes that the running of the statute of limitations can be tolled by mutual agreement of the parties. That position reflects a view of the law, however, to which we cannot subscribe. The limitations period applicable to the actions brought in this court is a condition that attaches to the sovereign's waiver of immunity from suit and "defines the limits of the . . . court's jurisdiction to hear a claim against the United States." *Henderson v. United States*, 517 U.S. 654, 677 (1996) (Thomas, J., dissenting). Moreover, those limits have been expressed in terms that admit of no qualification: "Every claim of which the United States Court of Federal Claims has jurisdiction shall be barred unless the petition thereon is filed within six years after such claim first accrues." 28 U.S.C. § 2501 (1994). Given the explicitness of this statutory language and recognizing also that it is to be read "with that conservatism which is appropriate in the case of a waiver of sovereign immunity," *United States v. Sherwood*, 312 U.S. 584, 590 (1941), this court is compelled to reject the notion that litigating parties can modify the terms that Congress has specified for the initiation of suits against the United States. "The matter is not one of procedure but of jurisdiction whose limits are marked by the Government's consent to be sued." *Id.* at 591. The FDIC's agreement with the Department of Justice to toll the statute of limitations is a legal nullity.

We turn then to the FDIC's second argument in support of the timeliness of its intervention—the assertion that, as the real party in interest, the FDIC may relate its

date of filing back to the date of the shareholder-plaintiffs' originally filed claim. In support of this position, the FDIC relies primarily on this court's rule 17(a) (and its virtually identical federal rules counterpart), which provides that an action filed by a plaintiff other than the real party in interest may be amended to permit either the joinder or the substitution of the real party in interest, with the subsequent action to be treated as if it had been "commenced in the name of the real party in interest." RCFC 17(a).[3]

In interpreting Rule 17(a), courts have uniformly held that where suit is commenced by one who arguably has an interest in the enforcement of the claim and the real party in interest is later brought into the litigation, the joinder or substitution of the real party in interest relates back for limitations purposes to the date of the original pleading. *See, e.g.*, *South African Marine Corp. v. United States*, 640 F. Supp. 247, 253-54 (Ct. Int'l Trade 1986); *Prevor-Mayorsohn Caribbean, Inc. v. Puerto Rico Marine Mgmt., Inc.*, 620 F.2d 1, 3 n.2 (1st Cir. 1980); *Link Aviation, Inc. v. Dooms*, 325 F.2d 613, 614-15 (D.C. Cir. 1963). As further explained in Wright's *Federal Practice and Procedure*, 6A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane

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[3] Under this court's Rule 17(a), an action may not be dismissed on the ground that it is not being prosecuted in the name of the real party in interest "until a reasonable time has been allowed after objection for ratification of commencement of the action by, or joinder or substitution of, the real party in interest; and such ratification, joinder, or substitution shall have the same effect as if the action had been commenced in the name of the real party in interest."

§ 1555 (2d ed. 1990): "The final sentence in Rule 17(a) is designed to avoid forfeiture and injustice when an understandable mistake has been made in selecting the party in whose name the action should be brought. Thus, a correction in parties is permitted even after the statute of limitations governing the action has run."

Defendant maintains, however, that the FDIC's intervention cannot relate back to the filing date of the original complaint because that complaint did not assert a claim on behalf of the failed thrift but rather a claim on behalf of the individual shareholders. As a result, defendant argues, "the FDIC cannot use the investor plaintiffs' complaint as a surrogate for [its] claim on behalf of [the bank]."

We cannot accept this contention. The core dispute presented in the complaint involves the government's breach, occasioned by the enactment of FIRREA, of specific contractual rights which the "FHLBB [Federal Home Loan Bank Board] granted Western Empire and its investors."[4] The source of these rights is identified as those "set forth in, *inter alia,* an Acquisition Approval Letter issued by FHLBB, and a Regulatory Capital Maintenance Agreement . . . entered into by the 'new' Western Empire, plaintiffs Castle and Harlan, and FSLIC." In view of these recitals, there can be no question that the contract rights brought into issue in the complaint implicate the bank's rights at least to the same extent as those of the shareholder-plaintiffs. Therefore,

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[4] The quoted material is taken from Paragraph 37 of the First Amended Complaint that was filed in this court on April 4, 1997.

the fact that the complaint filed sought recovery only in the name of the shareholder-plaintiffs (and not also the bank) can hardly provide a reason for saying that the FDIC should now be denied its rightful place in the litigation. The transaction sued on was a contract to which the bank was a party. Plainly, then, the bank had an interest in the subject matter of the suit. Hence, since the FDIC is the bank's successor-in-interest, the FDIC's intervention must be judged to relate back to the date of the original complaint's filing.

The FDIC's Standing To Intervene

Having concluded that the FDIC's intervention was timely, we turn now to the question of whether the FDIC is legally permitted to present the bank's claim. In challenging the FDIC's participation in this law suit, defendant has focused on two primary factors: the legal capacity in which the FDIC purports to prosecute this action (whether as the bank's receiver or as the manager of the FSLIC Resolution Fund),[5] and the nature of the receivership deficit claim the FDIC now asserts. Upon reflection, we are able to accept defendant's objections only as they pertain to the receivership deficit, and accordingly deem that receivership deficit (a full description of which we provide below) unrecoverable.

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[5] The FSLIC Resolution Fund was created as part of the banking reforms instituted by FIRREA. *See* 12 U.S.C. § 1821a(a)(1) (1994). The fund, which is managed by the FDIC, is the transferee of the assets and the liabilities of the Federal Savings and Loan Insurance Corporation (FSLIC). The FSLIC was abolished by FIRREA.

In analyzing the FDIC's proper role in this litigation, we begin with Judge Turner's decision in *Plaintiffs In All Winstar-Related Cases v. United States*, 44 Fed. Cl. 3 (1999).[6] Asked to determine the legitimacy of the FDIC's intervention in *Winstar* actions initiated by private plaintiffs, Judge Turner ruled that the FDIC could intervene as a matter of right since it bore the statutory obligation to "'take over the assets of . . . the insured depository institution,' 12 U.S.C. § 1821(d)(2)(B)(i), and to 'collect all obligations and money due the institution.' 12 U.S.C. § 1821(d)(2)(B)(ii)." 44 Fed. Cl. at 7. Based on these statutory responsibilities, Judge Turner concluded that the "FDIC as receiver of the failed thrifts has a duty to join in these cases (or in some manner pursue the thrifts' claims by litigation) in order to recover any damages owed by the government to the failed thrifts." *Id.* at 8. The FDIC could not, however, be substituted as the sole plaintiff to the exclusion of the shareholders, the court further held, since the shareholder-plaintiffs, suing derivatively, have "a direct, vested interest in the surplus of potential recoveries and, therefore, have standing to remain as plaintiffs in these actions notwithstanding FDIC's appearance on behalf of the failed thrifts." *Id.* at 11.

Defendant reads Judge Turner's decision as standing for the proposition that the FDIC may intervene only where the agency is acting in its capacity as the receiver

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[6] By consensus of the litigants involved in the Winstar-related suits (memorialized in an Omnibus Case Management Order dated September 18, 1996), individual judges were assigned decisional responsibility with respect to common issues, the resolution of which was to apply to all of the pending Winstar cases.

for a failed thrift. In defendant's view, however, the FDIC appears here not as the receiver for Western Empire, but as the manager of the FSLIC Resolution Fund. It is thus defendant's belief that the FDIC, acting as the Resolution Fund manager and hence as an agency of the United States, cannot now bring suit against the United States, as it amounts to an action by the government against the government. Such inter-governmental disputes, defendant maintains, are simply non-justiciable.

Defendant's characterization of the FDIC as fund manager rather than as receiver derives from two sources. Defendant argues first that the FDIC is precluded from acting as receiver since the receivership estate was terminated on May 31, 1995-a date well before the FDIC's motion to intervene was filed in this court-and the claims the receiver possessed were sold to the Resolution Trust Company ("RTC") in its corporate capacity. In addition, defendant notes that the claim itself was ultimately transferred to the Resolution Fund, which the FDIC, by law, is charged with administering. 12 U.S.C. § 1821a(a)(1). Those factors, defendant concludes, confirm that the FDIC is acting here solely in the capacity of Resolution Fund manager-with the result, in defendant's view, that the government is impermissibly suing itself.

In assessing the legitimacy of defendant's argument, we begin with a brief chronology of the inter-agency transfers of the bank's claim. According to a stipulated order by the parties (the entirety of which is set forth be-

low),[7] all of the bank's assets-including its breach of contract claim-were placed, after the bank's dissolution, into a receivership estate managed by the RTC as receiver. The RTC as receiver later assigned those claims to RTC in its corporate capacity and, within four month's time, terminated the receivership estate. The

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[7] The parties have stipulated to the following chronology tracing the bank's assets and liabilities:

> On February 15, 1990, the Office of Thrift Supervision ("OTS") appointed the Resolution Trust Corporation ("RTC") as Receiver for Western Empire. On or about the same date, the OTS also issued a charter for a new thrift named Western Empire Federal Savings and Loan ("Western Empire Federal") for which the RTC was appointed Conservator (the "thrift in conservatorship"). On February 16, 1990, the RTC as Receiver for Western Empire entered into a contract (the "Purchase and Assumption Agreement") with the thrift in conservatorship, by which substantially all of the assets of Western Empire, including this and other claims owned by Western Empire, were transferred to Western Empire Federal.
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> The thrift in conservatorship operated until August 31, 1990, when the OTS appointed the RTC as Receiver for Western Empire Federal. On February 1, 1995 the RTC as Receiver for Western Empire Federal assigned to the RTC in its corporate capacity this claim and other assets remaining in the receivership (the "Assignment and Assumption Agreement"), and the receivership was terminated on May 31, 1995.
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> On December 31, 1995, the RTC itself ceased to exist, pursuant to 12 U.S.C. § 1441a(m)(1). Pursuant to 12 U.S.C. § 1441a(m)(2), all assets and liabilities held by the RTC in its corporate capacity as of December 31, 1995 were transferred to the FSLIC Resolution Fund.

RTC corporate then ceased to exist pursuant to 12 U.S.C. § 1441a(m)(1) (1994) and its assets were transferred by statute to the FSLIC Resolution Fund. 12 U.S.C. § 1441a(m)(2). The FDIC, in turn, is now charged with the management of all claims residing in the Resolution Fund. 12 U.S.C. § 1821a(a)(1).

In light of that history, we cannot accept defendant's assertion that either the termination of the receivership estate or the transfer of the claim to the RTC corporate in any way constrains the FDIC's legitimate participation in this lawsuit. We are not aware of any authority that would suggest that the transfers of the claim among the various agencies reflected anything other than stages in the administrative implementation of FIRREA—a process that cannot be seen as substantively altering the claim itself. Indeed, in its capacity as manager of the FSLIC Resolution Fund, the FDIC is specifically granted "all rights, powers, and duties to carry out the Corporation's [FDIC's] duties with respect to the assets and liabilities of the FSLIC Resolution Fund that the Corporation otherwise has under this chapter." 12 U.S.C. § 1821a(a)(4). In other words, the FDIC has the same fiduciary duties and obligations with respect to the FSLIC Resolution Fund as it has as a receiver for an insured depository institution. Thus, the short answer to defendant's argument is that the FDIC is a participant in this lawsuit because it holds the bank's claim and is charged by law with pursuing it.

Defendant argues against this conclusion. It points out that the FDIC, when acting in its capacity as manager of the FSLIC Resolution Fund, is an agency of the United States; hence, to allow the FDIC, in that same capacity, to pursue the bank's breach of contract claim

against the United States is to present the court with a non-justiciable intra-governmental dispute.

As proof that the government is essentially represented on both sides of the litigation and that any recovery would amount to a transfer merely from one government account to another, defendant points to the statutory scheme for the payment and receipt of *Winstar*-related sums. According to defendant, the FSLIC Resolution Fund is charged by statute with reimbursing the government for all expenses incurred in defending the *Winstar* litigation. *See* Pub. L. No. 105-61, § 632, 111 Stat. 1272, 1315 (1997); Pub. L. No. 104-208, § 638, 110 Stat. 3009-364 (1996). Additionally, the fund must provide all the monies paid out as judgments or settlements in any of the *Winstar* suits. 12 U.S.C. § 1821a(d). Any shortfall in the fund's accounts, or any ultimate surplus, is to be made up by, or returned to, the United States Treasury. 12 U.S.C. § 1821a(c)(1), (f). Finally, defendant maintains that any recovery awarded by this court will be paid to the Resolution Fund, thus essentially positioning the fund on both sides of the litigation.[8]

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[8] It is unclear from the post-trial briefing whether defendant believes that an intra-governmental dispute arises only in connection with the FDIC's pursuit of the receivership deficit claim-*i.e.*, the claim for those funds that the RTC paid to the bank's depositors and which the FDIC now seeks to recover as subrogated creditor or whether it extends that argument to the breach of contract claim in its entirety. In either event, we conclude that it is only the FDIC's pursuit of the receivership deficit claim that may legitimately be characterized as a non-justiciable intra-governmental dispute.

What that tracing of funds ignores, however, is the nature of the underlying dispute. The FDIC's status as an agency of the United States when acting as manager of the FSLIC Resolution Fund is of no legal consequence here. Indeed, the FDIC holds that status even when it is acting in its capacity as a receiver for a failed depository institution. 12 U.S.C. § 1819(b)(1) (1994) ("The [FDIC], in any capacity, shall be an agency of the United States for purposes of section 1345 of Title 28. . . .")[9] Rather, what makes a lawsuit a non-justiciable intra-governmental dispute is not a seeming identity between the parties, but the absence of those genuinely distinct adversarial interests between litigants that are the traditional earmarks of a case or controversy. *United States v. I.C.C.*, 337 U.S. 426, 430-431 (1949) ("[C]ourts must look behind names that symbolize the parties to determine whether a justiciable case or controversy is presented."); *Navegar v. United States*, 103 F.3d 994, 998 (D.C. Cir. 1997) ("[F]ederal courts act only when the disputes brought before them involve sharply defined issues pressed by truly adversary parties with a genuine stake in the outcome."). Clearly, the bank's breach of contract claim against the United States—seeking as it does the expectancy damages allegedly owed to the bank, and through the bank to its shareholders—meets these requirements.

Indeed, any other view would mean that the RTC as receiver essentially extinguished the bank's breach of

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[9] The referenced statute, section 1345 of Title 28, grants the district courts original jurisdiction over "all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress."

contract claim when it transferred it to RTC corporate, since, under defendant's reasoning, the claim could no longer be vindicated by an agency of the United States. Neither the assignment agreement effecting the transfer of the claim nor the legislation governing the claim's disposition supports such a result. And we find that scenario particularly difficult to accept given that the FDIC is specifically charged with administering the claims in the FSLIC Resolution Fund. We are thus bound to conclude that the FDIC may indeed prosecute the bank's breach of contract claim.

i. The Receivership Deficit

The rationale that allows the FDIC to seek recovery for the bank's contract claim, however, does not extend to the amount referred to as the receivership deficit. The receivership deficit claim, briefly described, identifies the amount by which Western Empire's liabilities (primarily the money owed to its depositors) exceeded the value received for its assets upon the bank's liquidation. That claim, defendant contends, suffers from the same infirmity defendant alleged of the breach claim: it represents an impermissible suit by the government against the government. Here, we believe, defendant is correct.

The $55.5 million identified as the receivership deficit comprises, in part, $26.5 million paid to the bank's depositors by the RTC, $24.2 million in interest on that amount, and approximately $1.8 million in administrative expenses (including the FDIC's present litigation costs) in winding up Western Empire's accounts. The FDIC claims this deficit as a loss suffered by the bank. Defendant, in contrast, characterizes that deficiency as made up of the bank's preexisting liabilities—*i.e.* debts

in the form of money owed to creditors or depositors-that cannot now be transformed, through a damages award to the bank, into assets of the bank. Further, the fact that the insurance fund paid off the depositors (and in doing so became subrogated to their claims against the bank) means, in defendant's view, that the receivership deficit claim never belonged to the bank at all, but rather to the RTC as subrogee and then, by subsequent transfer, to the FSLIC Resolution Fund.[10] Finally, defendant notes, prosecution of the claim by the FDIC acting in its capacity as transferee of the RTC's rights as subrogee amounts to a claim against the government for money owed the government.

Defendant is of course correct that the liabilities owed to depositors were debts the bank itself had incurred prior to the breach. Plaintiffs are equally correct, however, that the forced sale of assets during a depression in both the real-estate and high-yield bond markets (as well as the fire-sale atmosphere created by the simultaneous closing of thrifts in the wake of FIRREA) likely resulted in a significant decrease in the value received for those assets. Yet, the various components of the receivership deficit—the payment to the depositors, the interest on that amount, and the subsequent expenses incurred in resolving the receivership estate—are ultimately claims *against* the bank, not claims *belonging* to the bank. We explain further.

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[10] The RTC, having paid the bank's depositors, became subrogated to the depositors' claims against the bank. The RTC's interests, including its interests as subrogee, were subsequently transferred to the FSLIC Resolution Fund (the fund managed by the FDIC). 12 U.S.C. § 1441a(m)(2).

Because the sale of the bank's assets upon dissolution was insufficient to meet the depositors' demands, the RTC, acting in its corporate capacity, paid off the outstanding deposits, and in doing so succeeded to the rights of the bank's depositors against the estate of the failed bank. The RTC corporate, in other words, became subrogated to the claims of the insured depositors. At the same time those payments were made, the RTC receiver entered into an assignment and assumption agreement that transferred to RTC corporate all of the assets and liabilities remaining in the receivership. Thus, by virtue of its ownership of the bank's assets, and its status as subrogee of the depositors' claim against the bank, RTC corporate became both an owner of and a creditor against the same institutional assets. It was in this same joined status that these ultimately competing assets were passed on to the FSLIC Resolution Fund.

The receivership deficit now being claimed thus represents the loss absorbed by the insurer of the bank's depositors; not by the bank. Consequently, any recovery on the claim by the bank would, in fact, have to be paid over to the bank's creditor-in this case, the FSLIC Resolution Fund (the successor to the subrogee, RTC corporate). Put in practical terms, the FDIC is thus asserting a claim—the receivership deficit—that first will transfer money from the FSLIC Resolution Fund to the bank and then from the bank back to the Fund. FDIC, in effect, is suing itself. Such an action amounts to a non-justiciable intra-governmental dispute and, as such, may not go forward here.

Shareholder-Plaintiffs' Right to Seek Lost Profits

In addition to taking issue with the FDIC's role in this lawsuit, defendant also challenges the right of the shareholder-plaintiffs to pursue a claim for expectation damages, *i.e.*, lost profits. Any expectation damages, defendant contends, belong not to the investors, but to the bank. And since the FDIC now purports to represent the bank's interests, defendant argues that the lost profits claim may be asserted by it alone. We are thus asked to rule that plaintiffs are precluded, as a matter of law, from pressing here their demand for lost profits. The FDIC joins in this request.

Plaintiffs do not dispute that the FDIC alone may pursue the bank's claim. In plaintiffs' view, however, the claim for expectation damages they are seeking is not the bank's claim, but rather their own. Plaintiffs contend that they have contract rights, independent of those held by the bank, for the breach of which they are now seeking recovery.

Plaintiffs trace the origin of these rights to two sources. First, they point out that both John K. Castle and Leonard M. Harlan were parties to the regulatory capital maintenance agreement (the basic contract document), where their signatures appear along with those of the representatives of the bank and the FSLIC. (The contract collectively identifies Messrs. Castle and Harlan as the "Acquirors.") Second, plaintiffs refer us to the earlier decision in this case (the decision on liability entered on February 2, 1999) in which Chief Judge Smith ruled that the "investor plaintiffs . . . are third party beneficiaries of the contract." 42 Fed. Cl. at 866. Based on these two sources, then, the shareholder-plaintiffs assert that they possess contract rights that

parallel the bank's own. To be more specific, plaintiffs contend that they are entitled to recover any lost profits the court might award, while the bank, they say, would be entitled to any recovery allowed with respect to the receivership deficit claim.

We do not agree with this position. Accepting, for the sake of argument, that plaintiffs in fact have an enforceable interest in the contract performance, we nevertheless fail to see how their status as third-party beneficiaries (or as signatories to the contract) can give them more than a right to sue here for the benefit of the bank. The contract performance that was promised was the granting of special regulatory forbearances which the government agreed to extend to the bank. And while plaintiffs could, of course, expect to benefit from that performance as the value of the bank grew, they held no rights to that performance for themselves. It was to the bank that the promised performance was to be rendered, not to the plaintiffs. Therefore, while plaintiffs' contract status would grant them a right to sue in the event of breach, they cannot claim more than they had in the first instance: a right to a benefit that can only come to them *through* the bank. Plaintiffs cannot lay claim to more than this, for the government promised nothing more. The lost profits claim belongs to the bank.

PART II

We turn now to the substantive portion of the case-plaintiffs' claim for damages. Under traditional damages theory, an injured party has available to it several measures of recovery: its expectation interest, its reliance interest and its restitution interest. An injured party may thus seek to recover the value of the bargain-as

measured by the economic position it would have attained had performance been rendered (referred to as the "expectation interest"); the investment the injured party has made in performance as measured by the economic position it would have been in had the contract not been made (referred to as the "reliance interest"); or the value of the benefit conferred on the breaching party (referred to as the "restitution interest"). Restatement (Second) of Contracts § 344 (1979).

Expectation Interest

The principal claim put forward here, and the primary focus at trial, is a claim for lost profits—the profits the bank would have earned had its operations not been halted by FIRREA. The problem presented is one of reconstructing events as they might have been.

To accomplish this task, plaintiffs engaged the services of a number of experts, two of whom in particular—Dr. Donald Kaplan and Dr. Robert Losey—provided much of the testimony that is central to this case. Dr. Kaplan, who testified on behalf of the shareholder-plaintiffs, is a former Chief Economist of the Federal Home Loan Bank Board and has twenty-five years' experience as an economist analyzing the thrift industry. Dr. Losey, the FDIC's expert, is a former financial economist with the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation, and currently serves as an associate professor and chairman of the Department of Finance and Real Estate at American University in Washington, D.C.

Starting with the core assumption that the bank would continue to pursue the basic lines of business set out in the business plan-investments in high-yield bonds,

mortgage-backed securities, and residential mortgages- each expert developed a sophisticated, computer-based model showing the expected growth, over a period of years, in the bank's revenues, costs, and profits, using numbers drawn from market data. Although the methodology and structure of their respective models were much the same, the results derived from the models were not. Differences in input assumptions led to differences in predicted outcomes: Dr. Kaplan concluded, for instance, that over the ten-year period extending from January 1, 1989 through December 31, 1998, the bank would have realized post-tax earnings of $73.9 million.[11] Dr. Losey, by contrast, determined that, over the same ten-year period, the bank's post-tax earnings would have come to $36.3 million.

Defendant challenges the validity of both models saying that neither satisfies the requirements necessary to support an award of lost profits. Those requirements, set forth most notably in the Court of Claims decision in *Chain Belt Co. v. United States*, 127 Ct. Cl. 38, 115 F. Supp. 701, 714 (1953), are three: First, that the claimed loss be "the immediate and proximate result of the breach"; second, that the loss be within the contemplation of the parties either because it was "natural and inevitable upon the breach" or because it arose from "special circumstances . . . known to the defaulting party at

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[11] In addition to the $73.9 million he identified as lost profits, Dr. Kaplan's calculation of expectancy damages included $52.9 million for the receivership deficit and another $15.2 million which he identified as a franchise premium, *i.e.*, the dollar amount, in excess of book value, for which the bank could be sold to outside investors.

the time the contract was entered into"; and third, that there exist "a sufficient basis for estimating the amount of profits lost with reasonable certainty."

In defendant's view, the experts' models incorporate assumptions that either ignore or are inconsistent with these substantive requirements-causation, foreseeability, and reasonable certainty. While we conclude ultimately that plaintiffs' models fail only the third of those elements-the requirement of reasonable certainty-the importance of the first two issues warrants our full discussion of them as well.

i. Causation

In its efforts to prove that FIRREA was not the proximate cause of plaintiffs' damages, defendant raises essentially two arguments, one grounded in law, the other in fact. With respect to legal causation, defendant maintains that the proximate cause standard is satisfied only where there exists a nexus between the breach and any subsequent damage such that there exists "no intervening incident . . . to complicate or confuse the certainty of the result between the cause and the damage." *Myerle v. United States*, 33 Ct. Cl. 1, 27, 1800 WL 2024 (1897). Again quoting *Myerle*, defendant elaborates on the point by emphasizing that "the cause must produce the effect inevitably and naturally, not possibly nor even probably. . . . There must not be two steps between cause and damage." *Id.*

These constraints, defendant asserts, have not been observed here. Rather, defendant notes that the starting point in each of the experts' models is an assumed capital infusion (by the original investors) of approximately $10 million—an augmentation of capital made neces-

sary by losses experienced during the first twelve months of operation.[12] In defendant's view, the introduction of this factor into the experts' models introduces "two steps between cause and damage"; hence, the claimed damages cannot be said to result "inevitably and naturally" from the enactment of FIRREA. Instead, defendant describes these as damages from a "collateral undertaking"—a term used by the courts to describe damages for profits lost on transactions not directly related to the contract that was breached. *See, e.g.*, *Wells Fargo Bank v. United States*, 88 F.3d 1012, 1022-23 (Fed. Cir. 1996) (citing *Ramsey v. United States*, 121 Ct. Cl. 426, 101 F. Supp. 353 (1951), *cert. denied*, 343 U.S. 977 (1952)) (ruling that the government's liability for breach of a loan guarantee contract could not include profits the bank might have earned from additional loans it would have been able to make had its lending capacity not been diminished by the government's failure to honor the guarantee).

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[12] In his model, Dr. Kaplan assumes a $10 million capital infusion in January 1990 in order to bring the bank into compliance with its 2% tangible capital requirement and thereby avoid seizure. Of that amount, Dr. Kaplan testified that $4.7 million would have been necessary immediately (*i.e.*, in January 1990) to ensure capital compliance, with the balance reserved to cover losses the bank would suffer in 1991. Dr. Losey, by contrast, assumed two infusions rather than one, each timed to cover a capital shortfall, and hence maintain capital compliance. Dr. Losey's model thus assumes a $5 million infusion in the first quarter of 1990 (which, as in Dr. Kaplan's model, is intended to remedy a capital shortfall that is traceable, in part, to asset write-downs and bond defaults) and a $4.7 million infusion in the first quarter of 1991 (again to remedy a capital deficiency caused by bond defaults).

We cannot accept defendant's argument. The statement in *Myerle* that defendant emphasizes in its brief—the prohibition on "two steps between cause and damage"—means only that, in the proof of damages, a party may not rely on transactions or occurrences that do not flow directly from the contract itself. Put differently, *Myerle's* requirement of a direct link between breach and injury is satisfied where subsequent events—including a capital infusion—can be seen as steps reasonably to be taken in pursuit of the business structure, methods and goals as set forth in the contract. The collateral undertakings envisioned by *Myerle* and *Wells Fargo* are those which fall outside of the scope of the original contract; proximate causation is thus compromised only where an *extra-contractual* transaction is interposed between the breach and any subsequent damage.

The issue, then, is one of constructing the course of events that might have evolved to fulfill the contract's purpose and comply with its terms. To the extent that a capital infusion represented the natural progression of the contract's fulfillment, it can be seen neither as a collateral transaction nor as an additional, impermissible step in the chain of causation. The question we ask, therefore, is whether the assumed infusion of an additional $10 million dollars by the bank's investors describes an event whose occurrence logically could be contemplated in light of the business structure described in the contract documents.

In answering that question in the affirmative, we look first to the bank as it was initially envisioned and second to the bank as it actually evolved. Under the business plan, Western Empire was originally to be

funded with a $25 million capital base-to be divided equally between equity and subordinated debt. Although the bank in reality began operations with less than this amount ($15.1 million was the initial capitalization, of which $2.6 million represented subordinated debt), the record makes clear that both the organizers of the enterprise (John Castle and Leonard Harlan) and the government regulators understood that the bank was a venture whose capital needs might exceed this initial contribution. And just as the business plan anticipated the raising of additional funds in principle, Western Empire set out to raise those funds in practice by hiring an expert to place additional subordinated debt.[13] Given this evidence, we think it fair to say that the funding assumptions contained in the models is descriptive of a course of action that is consistent with the intentions embodied in the contract. It is appropriate, therefore, to conclude that that funding assumption is not an improper link in the chain of events identifying FIRREA as the proximate cause of plaintiffs' damages.

We turn then to defendant's second argument against causation. Defendant contends that, even if the models' funding assumptions do not preclude us as a matter of law from considering FIRREA as the proxi-

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[13] The effort to raise additional capital through a supplementary subordinated debt offering was abandoned in mid-1989, after only a brief effort, because of a combination of factors that rendered the high-yield bond market temporarily unattractive. These factors included the market's preoccupation with a then-occurring multibillion dollar leveraged buyout as well as emerging concerns about the prospects of adverse banking legislation-a reference to what later was enacted as FIRREA.

mate cause of plaintiffs' damages, nevertheless, as a matter of fact, we would be obliged to come to that conclusion. Specifically, defendant maintains that, as of January 1990 (the date the models begin), the bank was a "shop operating at the margin"—an institution in such financial turmoil as to render additional investment in it inconceivable and to cause regulatory authorities to initiate supervisory actions against it. FIRREA, in other words, would have had no effect on the bank because its closure would have occurred even in the absence of a breach.

Two assumptions he at the heart of defendant's factual causation argument. First, defendant contends that the capital infusion envisioned by Dr. Kaplan and Dr. Losey's models would not have been forthcoming—thereby resulting in the bank's seizure for capital noncompliance. Second, defendant argues that, even in the event of a capital infusion, the bank's questionable business practices would have led to its demise (in part because safety and soundness concerns would have forced its seizure). We discuss those arguments in turn.

In defendant's estimation, the fact that Western Empire would have required a capital infusion merely to survive—the result of a shortfall concededly unrelated to FIRREA—is prima facie evidence that the bank would not have remained in operation even in the absence of the breach. Defendant correctly states—and plaintiffs concede—that without a capital infusion in January 1990, Western Empire would have fallen out of capital compliance and been subject to seizure. Dr. Kaplan remedies this problem by assuming a $10 million, investor-provided capital contribution in the first quarter of 1990; Dr. Losey addresses it with a $5 mil-

lion infusion during the same period. Defendant, with a few minor exceptions discussed below, does not dispute that the proposed infusion would have returned Western Empire to capital compliance. Rather, it argues that, in reality, Western Empire would not have been able to raise the funds on which the models rely. A key component of plaintiffs' damages models, then, turns on the court's willingness to accept the premise that plaintiffs would have invested an additional $10 million to keep Western Empire afloat.

Defendant challenges that assumption on the grounds that, given the bank's failure to achieve its stated performance goals, and in light of a less-than-hospitable regulatory climate, an additional infusion made no business sense. Defendant additionally maintains that the entire exercise of assuming an infusion is tainted by hindsight, since the investors could not contemporaneously have known the amount of capital that would ultimately have been necessary to avoid seizure. Finally, defendant contends that, despite the investors' testimony that they would have made a second capital infusion, no evidence exists to support the assertion that they would in fact have invested additional sums.

Defendant's arguments, though well-taken, are ultimately unpersuasive. While there would obviously have been a point at which the investors would have abandoned this business as unprofitable, several factors lead us to the conclusion that that point had not yet been reached. Fifteen of the original investors testified convincingly that they were both willing, and in a position, to pledge the funds required. The majority of those investors had longstanding relationships with John Castle—the driving force behind Western Empire's acquisi-

tion—and many testified that his endorsement alone was sufficient recommendation to warrant an additional investment. Not insignificantly, John Castle himself is a man who, by all accounts, stands by his investments, even in those instances where the bottom line alone can not justify his continued involvement. Mr. Castle testified convincingly that he had intended to see his investment in Western Empire through, a statement bolstered not only by his personal history, but by his discussions with the investors in the wake of FIRREA. We have no reason to question either that Mr. Castle would have sought the $10 million capital infusion required or that the investors would have contributed the amount he requested.

Nor is it lost on the court that the takeover and turnaround of weak or undercapitalized businesses was Castle Harlan's specialty. Indeed it would be difficult to imagine, even in light of the fact that the results from the bank's first year of operations were less favorable than projected, that an organization devoted to the turnaround of underperforming businesses would, in less than a year's time, essentially abandon its undertaking. The losses to which defendant points as evidence of the bank's demise—an alleged year-end operating loss for 1989 of $7.1 million rather than the reported $1.9 million—are questionable both in their accounting legitimacy and in their relevance to the bank's financial prognosis.[14] But even were we to accept defendant's num-

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[14] Of the $5.2 million in losses defendant believes should have been reported in the 1989 year-end financial statements, $2.5 million represents an additional set-aside of general valuation allowances (GVAs), $1.1 million represents the loss on a defaulting

[Footnote continued on next page]

bers, the losses more reflect the resolution of problems inherited from the old bank than any indictment of the strategies pursued by the bank in its new form.

Indeed, at the heart of our conviction that an infusion would have been forthcoming is that the fundamentals of the original business plan had not changed. The strategy of using federally insured deposits as a low-cost source of funds to buy high-yield bonds and capitalize on the spread was no less appealing in 1990 than it had been at the time of the original investment. Many of the investors in fact testified that, despite the decline in the bond market in the early 1990s, their original approach was unaffected by the market changes. The fact that bond prices were depressed during that period, only

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[Footnote continued from previous page]
bond, and $1.6 million represents the 50% write-down of a bad real estate loan. Without going into those subjects at length, we note only that defendant's adjustments to the bank's balance sheet and income statements, even if accepted, do little to change the financial complexion of the institution. In the case of the bond, the dispute is merely one of timing: whether, as an accounting matter, Western Empire should have recognized the loss in December, before the bond's actual default, rather than in January as plaintiffs' models assume. We are at a loss to see how either alternative significantly changes Western Empire's financial prognosis. Similarly, increases in GVAs, while carried on the books as a "loss" for accounting purposes, are merely set-asides of funds in the event of future defaults, and do not, by contract, get subtracted from capital in calculating capital compliance. Finally, the incomplete write-down of the Queen's Bay real estate loan was a matter of much dispute, but, given the efforts of management to work-down the bad real estate inherited from "old" Western Empire, would hardly have come as a surprise to investors or, we believe, affected their decision to reinvest.

made the investment more attractive in the investors' view.

And while it may indeed have been difficult for John Castle to have made repeated phone calls to investors as each new capital shortfall became apparent, we are confident that through a combination of debt placement and strategic equity raising (requesting a greater amount than necessary at a single time rather than several smaller contributions, for instance), Western Empire could have presented a financing plan that would indeed have been attractive to investors.

Ultimately, then, we believe that a capital infusion provided by the original investors represents the best and likeliest solution to the shortfall Western Empire faced. Accordingly, we have no difficulty accepting it as a key factor in plaintiffs' models.

Yet, even if many of Western Empire's immediate problems would have been remedied with a capital infusion, defendant nonetheless maintains that the bank's risky or failed business practices would still have ensured its demise. Under this theory, FIRREA was not the actual cause of Western Empire's failure because safety and soundness concerns would have forced the regulators to seize the bank even in light of a capital infusion. In support of this assertion, defendant notes that in its first twelve months of operation, the bank, instead of operating profitably as had been anticipated, actually lost money, as residential mortgage loan originations fell far short of projections and more than half of the properties acquired through loan defaults remained unsold. In addition, defendant points out, the bank had begun to face liquidity concerns as it was forced to fund its high-yield bond portfolio chiefly with short-term brokered

deposits (deposits that, characteristically, are more volatile), rather than through a planned collateralized bond undertaking and longer-term certificates of deposit.

In addition to these operational concerns, defendant contends that the bank did not adhere to proper accounting procedures. In defendant's view, the bank overvalued assets, underfunded required reserve accounts, and incorrectly amortized goodwill. According to defendant, the net result of these departures from accepted accounting standards was an institution whose income, as well as its capital, had been grossly overstated. Moreover, because of this overstatement of capital which, in effect, amounted to an overstatement in growth capacity-the bank was correspondingly able to increase its holdings of high-yield bonds to a level that, had the capital been correctly calculated, would not have been permitted. In short, defendant portrays the bank as an institution short on capital and long on risk. Defendant argues, therefore, that in the heightened oversight of banking institutions that characterized the post-FIRREA world, safety and soundness concerns would have led regulatory authorities to seize the bank and close-down operations.

The various concerns defendant has raised here are both serious and, for the most part, factually correct. We do not believe, however, that those concerns lead to the conclusion that regulators would have forced the bank to close it doors. As an initial matter, the shortfall in performance results that defendant has cited does not, of itself, present safety or soundness concerns. At most, those results bear witness to a business environment that presented challenges to Messrs. Castle and Harlan more demanding than their business plan had envisioned.

By no means could the bank's one year of operation under plaintiffs' stewardship be used as a gauge against which to assess the safety and soundness of the institution. This was, after all, a "turn-around" situation in which a new business format (the linkage of traditional mortgage lending with investments in high-yield bonds and mortgage-backed securities) was being used to rescue a financial institution whose past mistakes (over-reliance on commercial real-estate loans that subsequently defaulted) presented a formidable drag on the "new" bank's earnings. Given the magnitude of the portfolio "work-down" confronting the bank at the start (disposing of roughly $11 million dollars worth of bank-owned real estate arising out of loan defaults), it is hardly surprising that the progress towards profits was slow.

As to the accounting issues that defendant raises, it is difficult to see how those issues could retain any validity, *i.e.*, present safety and soundness concerns, given a capital infusion of $10 million. An infusion of that amount would be more than sufficient to restore the bank to a position of capital adequacy. And that would be true even if the asset valuations that defendant challenges were resolved largely in its favor.[15] Thus, while safety and soundness issues could perhaps arise again in

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[15] Of the several asset valuations that defendant has challenged, two, in particular were the subject furniture, fixture and equipment by $1 million dollars and its building premises by $.5 million. Reflecting these restated values on the bank's books of account would, *inter alia*, reduce its tangible assets (*i.e.*, capital) by $1.5 million-a reduction that would, in turn, be remedied by an augmentation of capital derived from the capital infusion.

the later years of the bank's operation, it certainly cannot be said that such issues would have supported a seizure of the bank in early 1990.

We thus find no reason, grounded either in law or in fact, to conclude that the bank's damages resulted from anything other than the government's breach. Accordingly, we find that plaintiffs' burden in establishing causation has been met.

ii. Foreseeability

We turn then to the second component of plaintiffs' proof of damages: the requirement of foreseeability. Under that doctrine, a plaintiff is entitled to recover only those damages that the party in breach had reason to foresee as the probable result of a breach at the time the contract was entered into. Restatement § 351(1). Plaintiffs, defendant maintains, have failed to satisfy this burden.

In defendant's view, the lost profits that plaintiffs are claiming were not foreseeable because "the purpose of the alleged contract was to recapitalize [the bank] to return it to a safe and sound condition." In that context, defendant notes that "[p]rojected profits were significant only to the extent they may impact on [the bank's] safety and soundness." Profits, defendant argues, "were neither assured under the alleged contract" nor reflective of "the shared understanding of the parties."

Defendant's position, however, misinterprets the applicable law. The requirement of foreseeability may be satisfied either by showing that the loss claimed follows from the breach "in the ordinary course of events" or "as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to

know" when he made the contract. Restatement § 351(2). Virtually all of the evidence presented at trial confirms that the government should have known—and in fact did know—about the profit expectations that led plaintiffs to agree to the contract. Indeed, the government cannot credibly maintain that the potential for profit, without which plaintiffs would have had no incentive to complete the deal, was not within its contemplation. The record makes clear that plaintiffs were forthright in communicating their profit expectations, and the regulators clearly understood the character of plaintiffs' undertaking, a fact evident from the various risk limitations they included in the contract (the asset percentage limitations on high-yield bonds, the risk-weighted capital requirements for different asset classes, and the two-percent tangible capital requirement). The effort to manage risk in this specific manner permits only one conclusion: the regulators understood plaintiffs' goals and recognized the unique risk characteristics of the investments plaintiffs intended to pursue.

Nor is it sufficient to argue, as defendant does in its post-trial briefs, that the object of the contract, from the regulators' standpoint, was merely to restore the bank to safety and soundness without regard to profits. That objective necessarily contemplates the restoration of the bank to a level of profitability. The two go hand-in-hand. Had either party anticipated failure, the transaction would have served neither's needs.

It would follow, therefore, that in being deprived of the opportunity to proceed with the contract, plaintiffs were deprived of any profits that reasonably might be associated with such an undertaking. Those are the profits which plaintiffs seek here. Those too are the profits

which defendant understood were the object of the bargain from plaintiffs' standpoint. Foreseeability has thus been established.

iii. Reasonable Certainty

We come then to the third and final element in the proof of lost profits: the requirement of reasonable certainty. Even those damages that are proximately caused by a breach and are the foreseeable result of it remain unrecoverable if they are, in the words of the Restatement, "beyond an amount that the evidence permits to be established with reasonable certainty." Restatement § 352. Courts have interpreted that requirement as calling for reasonable certainty with regard to the *fact* of damages rather than the *amount,* and have accordingly imposed a lesser standard of proof in the calculation of damages whose existence has been sufficiently established. *See Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931).

In *Chain Belt*, 115 F. Supp. at 714, the Court of Claims adopted that principle, noting that "if the fact of damage ... is certain, uncertainty as to the precise amount lost is not necessarily fatal to recovery." *See also Petrovich v. United States*, 190 Ct. Cl. 760, 421 F.2d 1364, 1367 (1970); *Neely v. United States*, 152 Ct. Cl. 137, 285 F.2d 438, 443 (1961). We thus begin our assessment of plaintiffs' proof with an inquiry into whether plaintiffs have established the existence of damages with reasonable certainty.

We note, as an initial matter, that the claim for lost profits is, at bottom, a prediction about the success the bank could have expected to achieve had it been permitted to proceed with performance under its contract. In

order for such a claim to satisfy the reasonable certainty standard, the proof relied upon must be rooted in fact. The court, in other words, must be able to look either to the actual performance of the bank or to the experiences of the industry of which it is a part, to ensure that the profits being claimed are consistent with the projected extension of the bank's economic activity. A claim whose basic structural components lack such factual foundation is simply speculation.

The lost profits models that plaintiffs' experts presented to the court offer an in-depth picture of how the bank was expected to conduct its affairs over the period of the 1990s. Each of the models presents its data in the form of yearly balance sheets and income statements together with all subordinate accounts. The information given is extensive. Taken at their most elemental level, however, the models portray a business venture whose overall profitability depended on three fundamental factors: the way it funded its assets, the return it received on those assets, and its success in reducing or eliminating its embedded costs.

As to the first of these three structural factors—the bank's anticipated funding sources—we have little reason to question the reasonableness of the assumptions contained in the models. Both experts assumed that the bank would draw its lendable funds from essentially three sources: retail deposits (*i.e.*, passbook accounts and short-term certificates of deposit); brokered deposits (*i.e.*, short-term deposits traceable to funds maintained in brokerage accounts); and non-depository borrowings (*i.e.*, borrowings from the Federal Home Loan Bank in San Francisco (Dr. Kaplan's assumption) or short-term

collateralized borrowings known more generally as reverse repurchase agreements (Dr. Losey's assumption)).

Our endorsement of these funding sources as transactions reasonably likely to have occurred (had the bank been permitted to proceed with its contract in the post-FIRREA world) is grounded in the fact that these borrowing sources correspond, in the main, to the manner of operation that characterized the bank's activities during the twelve months of its actual existence.

The exception is Dr. Kaplan's partial reliance on borrowings from the Federal Home Loan Bank in San Francisco. In mid-1989, the bank had attempted to gain access to a line of credit at the Federal Home Loan Bank, but was rebuffed in this effort because of a number of deficiencies, including a weak earnings performance, a high level of problem assets, a low level of capital, and an unproven operating strategy. Dr. Kaplan's assumption was that with the reduction in the bank's problem assets that had occurred over the remainder of 1989, and with the significant enhancement in the bank's capital structure that would result from the model's assumed infusion of $10 million, the bank would be able to establish its credit-worthiness with the Federal Home Loan Bank. We think this assumption has behind it sufficient factual substance to warrant its acceptance here as an event that would be reasonably certain to have occurred. In sum, then, the court accepts the legitimacy of the funding assumptions depicted in the experts' models.

The second structural component of the experts' models that meets the test of reasonable certainty is the rate of return that the models assign to the bank's principal earning assets—the high-yield bonds, mortgage-backed securities, and residential mortgages. In each of

these areas of investment, the rates of return the models adopt are the actual rates of return that were realized in the marketplace (during the years depicted in the models) on assets of the same kind and character as those held by the bank.[16] In constructing a hypothetical bond portfolio, for example, the experts incorporated the actual purchases that Western Empire's former investment manager made for a fund whose stated investment strategy and whose previous bond purchases closely matched

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16 During the pretrial phase of this lawsuit, defendant took issue with plaintiffs' intended reliance on post-breach data to establish the rates of return the bank would have received on its earning assets in the post-FIRREA world. Defendant contended that the use of post-breach evidence to fix the amount of damages was legally impermissible. The rule in this circuit, defendant maintained, requires damages to be determined as of the time of breach.

The court rejected this argument. Defendant was correct, we concluded, in saying that damages are to be determined as of the date of breach. *See, e.g., Reynolds v. United States*, 141 Ct. Cl. 211, 158 F. Supp. 719, 725 (1958). In the application of this rule, however, courts can—and indeed, should—consider post-breach evidence if, by doing so, they can more accurately measure the value of the contract expectancy in place at the time the breach occurred. In other words, damages should reflect what would have been gained (or lost) had performance been allowed to proceed. The Restatement's illustrations confirm this point. *See, e.g.*, Restatement § 352 cmt. b, illus. 6, § 344 cmt. b, illus. 5. The aim is to compensate an injured party for the loss actually sustained, *i.e.*, to "put him in as good a position as he would have been in had the contract been performed," to the extent it is possible to do so. *Id.* § 347 cmt. a. Unquestionably, prior decisions in this court have looked to post-breach evidence when considering lost profits claims. *See, e.g., Chain Belt*, 115 F. Supp. at 718; *Neely*, 285 F.2d at 443.

Western Empire's. That approach, we concluded, evidenced the highest degree of reliability.

Similarly, with regard to the bank's second largest asset category—the adjustable-rate mortgage-backed securities—the rates of return adopted in the models are taken from published data reporting the yield of mortgage-backed securities issued by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. In addition, the rates of return shown in the models correspond closely to the yield that was actually realized by the bank in 1989 on its adjustable-rate mortgage-backed securities portfolio.

Finally, as to the bank's retail mortgage portfolio (including both fixed-rate and adjustable-rate mortgages), the yields shown in the models were based on the prevailing Federal Home Loan Mortgage Corporation rates (for the fixed-rate mortgages) and on the cost-of-funds index and one-year Treasury rates (for the monthly and annually adjustable-rate mortgages) as reported in official publications. The models assume that the portfolio mix between adjustable and fixed-rate mortgages would correspond to market breakdowns.

Dr. Kaplan's model additionally assumes that the bank would be able to grow its mortgage banking business to approximately $20 million worth of mortgage originations per month by the end of 1991 (from approximately $8.5 million monthly experienced during 1989) and, in subsequent years, to sustain a mortgage origination rate roughly equal to one quarter of one percent of the state-wide annual originations volume. Defendant criticizes these numbers, particularly the above-industry growth rates attributable to 1990 and 1991. We think these projections in growth are legitimate, how-

ever, given that they are, in fact, simply a scale-back of numbers that were actually achieved during the years in question by a mortgage banking business operated by the same complement of personnel that the bank would have employed had it remained in business."[17]

Taken as a whole, the models' assumptions that the bank's total investment portfolio would have yielded positive returns is well supported. Given this conclusion, and given also the conclusion previously reached—that plaintiffs have established with reasonable certainty the bank's access to reliable funding sources for its expected investments—we come then to the decisive issue in the case: whether the expenses identified in the models as the bank's expected costs of operation have been established with sufficient certainty to support the conclusion that, over time, the bank would have become a highly profitable venture. It is this issue that occupied so much of the parties' time at trial. After much deliberation, we conclude that, in this aspect of their composition, the models' assumptions do not rise to the level of reasonable certainty.

Two matters in particular are of concern: the models' assumptions regarding the bank's commercial real estate portfolio and the assumptions made in respect to the bank's interest-rate hedging strategy. We discuss these in turn.

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[17] As indicated, the growth in the bank's mortgage banking business that is set forth in the opinion pertains to Dr. Kaplan's model only. Dr. Losey's model relies on slightly different assumptions but reaches a result that does not sufficiently differ from Dr. Kaplan's model to warrant separate discussion.

In the only year of its operation, 1989, the bank's revenues and net income were seriously affected by the troubled real estate loans and foreclosed-upon properties that remained from its earlier years' venture into commercial real estate lending. Of the $31.7 million dollars in commercial real estate loans that were on the bank's books at the start of 1989, nearly one-half ($14.8 million) had been classified as "substandard," *i.e.*, loans whose expected repayment in full was now questionable because of a subsequent impairment in the borrower's paying capacity and/or a deterioration in the adequacy of the underlying collateral. Substandard loans hold out the distinct risk that the lending bank will suffer some loss.

In addition to the substandard loans, the bank was also carrying a portfolio of foreclosed-upon commercial real estate properties (referred to as "real estate owned" or "REO") amounting to $11.4 million. Real estate owned generally signifies property that has lost value relative to the underlying loan amount and consequently implies a loss to the bank. Additionally, real estate owned represents non-interest earning assets that further burden a bank with the expenses of property ownership including taxes, insurance, utilities, and maintenance.

By the end of 1989, this drag on earnings had been only partially alleviated: substandard loans had been reduced to $8.4 million (presumably through refinancing arrangements) and real estate owned had been reduced to $6.1 million (through sale of the properties involved).

It is these year-end numbers—$8.4 million of substandard loans and $6.1 million of REO—that are carried over to the experts' models. In the incorporation of these values into the bank's projected operations, three

assumptions are made. First, the models assume that the bank would be able to dispose of these underperforming assets over a two-year period; second, that the assets would be sold at their net book value without the need for further increases in the bank's loan-loss reserves beyond amounts established at the end of 1989; and, third, that the remainder of the bank's commercial real estate loan portfolio (amounting to approximately $13 million as of January 1990) would experience no further deterioration in performance-quality. At base, then, the models presume that the credit quality of the bank's commercial real estate loan portfolio and the booked value of its REO would remain unchanged over the years 1990 and 1991.

This is not an assumption we can accept. The evidence reveals that the years 1990 and 1991 witnessed a significant downturn in the general economy, with the commercial real estate markets in Arizona and California (the situs of the bank's commercial real estate loans) being particularly hard hit. Under these circumstances, one cannot say with any degree of certainty that the bank would escape the necessity for further write-downs either in its commercial real estate loan portfolio or in the properties it acquired through foreclosure.

Dr. Kaplan answered this concern by pointing out that the bank had undergone a rigorous "safety and soundness" examination in the fall of 1989 and hence, in his view, its commercial real estate loans could be expected to withstand the strains of a declining economy without further downward adjustments in value. Although this argument is not unreasonable in its own right, we are compelled to note that over this same period of time (1990-1991), the experts' models assume an

absence of growth in the bank's balance sheet for a variety of reasons, including, as Dr. Kaplan notes in his report, "weakening conditions in the Arizona and California real estate markets." In the face of this observation-one which other evidence in the record fully supports-the court cannot accept, as reasonably certain, Dr. Kaplan's assumption that the reevaluation and reclassification of the bank's commercial real estate loan portfolio that occurred as part of the FDIC's 1989 bank examination would have been sufficient to eliminate the need for future write-downs in that portfolio. And such write-downs, were they to occur, would, of course, have diminished the bank's assets and, correspondingly, would have given rise to a need for additional capital beyond the $10 million infusion that the models have assumed.[18]

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[18] Although the views expressed in our opinion are specifically directed to Dr. Kaplan's model, similar criticisms would also apply to Dr. Losey's model. Whereas Dr. Kaplan's model assumes that no further write-downs in commercial real estate values would be required beyond those noted in the bank examination conducted in the fall of 1989, Dr. Losey's model takes essentially the opposite approach. That is to say, Dr. Losey's model disregards the write-downs reported in the bank examination and, instead, assumes, that the bank's commercial real estate portfolio would experience a deterioration in value roughly equal to the deterioration recorded by those thrift institutions that survived the California real estate decline. As defendant's expert pointed out, however, such an approach not only disregards the fact that the loans had already been identified as troubled loans, but compounds that error by using as a yardstick numbers that are inherently biased because they exclude the results (*i.e.*, the losses) of institutions that did not survive the downturn in the California economy.

The need for an additional capital infusion is a point whose significance we return to later. For the moment, however, we move on to discuss the other component of the bank's various projected expenses that is of particular concern to the court, namely, the change in the bank's interest rate hedging strategy that was incorporated into the experts' models.

First, some explanation. Savings and loan institutions (or "thrifts") are fiscal intermediaries—institutions that borrow funds from one source, the thrift's depositors, and lend them to another source, the thrift's borrowers. The expectation is that the difference between the cost of funds (*i.e.*, the interest rate paid to the depositors) and the rates of return realized upon the lending of those funds, will be sufficient, after allowance for all costs of operation, to yield a profit. In the management of this business, a particular difficulty that thrifts confront (along with other large lending institutions) is that the earning assets (*i.e.*, loans to borrowers and other investments) typically mature at a later date than the liabilities that are used to fund them (*i.e.*, deposits). Because of this timing difference, thrifts run the risk that as their deposits mature, the cost of replacing them with other deposits may have increased due to an intervening increase in interest rates. In such a situation, the thrift would experience a decline in earned income because of the narrowing of the spread between the interest being earned on assets and the interest being paid on liabilities. Indeed, in extreme cases, the spread can become negative, thereby eroding the thrift's capital base. This was, in fact, the condition that befell a large segment of the thrift industry in the 1980s.

To guard against these risks, thrifts now employ a variety of interest rate hedging strategies, two of which are of importance to this case: swaps and Euro-dollar CD put options. (CD refers to "certificate of deposit.") In a swap contract, the bank agrees to pay a counter-party a fixed rate of interest each month—say 9% on a notional amount of $180 million—in exchange for an agreed-upon variable rate (one that usually tracks the prevailing short-term interest rate). Thus, if the short-term rate-and hence the rate the bank must pay to attract deposits goes above the fixed rate of 9%, the bank receives payments from its counter-party that it can in turn use to pay its depositors. If the short-term rate falls below the fixed rate of 9%, the bank is able to pay less than 9% to attract deposits, but is obligated to pay the difference between the 9% and the short-term rate to its counter-party. Under either scenario, then, the bank's cost of funds remains at 9%. In this manner, the bank trades away the risks associated with the variability of the short-term interest rate in favor of the certainty of a fixed-payment obligation.

With a put option, by contrast, the bank avoids the burden of a fixed-rate payment but assumes the short-term risk. That is the case because a put option allows its purchaser to exercise the option—*i.e.*, issue a certificate of deposit at a pre-agreed interest rate at a pre-set time-only when doing so would be to the financial advantage of the purchaser. Put differently, an option holder whose contract allows it to issue a CD at 9% in three-month's time, would choose to exercise that option only if, at the three-month mark, prevailing interest rates exceeded 9%. (The bank would thus be able to issue CDs, *i.e.*, obtain deposits, for lower than the rate it

would be forced to pay on the open market.) If instead the interest rates were lower than 9% at the three-month mark, the option holder would simply decline to exercise its option. Put options thus allow a bank to place a cap on its cost of funds, while at the same time (and in contrast to swap contracts) taking advantage of declines in interest rates. As interest rates rise, however, the price of put options rise as well (in contrast to swap contracts, which have no initial cost).

Returning now to the facts, in the early months of its operation under Castle Harlan's management, the bank began a rapid build-up of its high-yield bond portfolio, funded primarily with brokered deposits. At the same time, it turned to interest rate swaps as the principal hedging mechanism through which to protect itself against the interest-rate risk exposure inherent in shorter-term liabilities. Thus, by the end of 1989, the bank had become a counter-party to some 18 separate swap agreements under the terms of which it was obligated, as the fixed-rate payor, to pay an average interest rate of 9.63 percent on a total notional amount of approximately $180 million.

In the main, the swaps worked well for the bank. In the first five months of their use in 1989 (April through August), the exchange of interest rates favored the bank, *i.e.*, the variable rate exceeded the fixed rate, and the bank therefore earned interest income (from the swaps) in each of these months. Over this five-month period, the bank recorded approximately $142,000 in swap-derived income. In the final four months of the year, however, short-term rates began to fall below the bank's fixed-rate obligation; hence reversing the direction of the pay-out owing under the swap contracts. The bank

now became the paying party. Over the final four months of the year, the swap contracts cost the bank approximately $262,000.

It is this change in the relationship between long and short-term interest rates that the bank experienced in the final four months of 1989—the return to what is called the normal yield curve—that takes us now to the experts' models and to the change in hedging strategies that those models have assumed: the abandonment of swaps in favor of Euro-dollar CD put options.[19]

No single assumption included in the experts' models is more central to the ultimate profitability of the bank than the bank's change in hedging strategies from interest rate swaps to Euro-dollar CD put options. Had the bank remained a counterparty to the swaps, it would have required a much larger capital infusion than the $10 million the models assume. To quote Dr. Losey, the expert to whom the change in hedging strategies is attributable:[20] "It's possible that if they had stayed in the [swap] hedge entirely, it's possible that the infusion needed would have been 15, 18, 20 [million dollars]—I'm not sure how much money but substantially more."

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[19] Euro-dollar certificates of deposit are dollar deposit claims upon U.S. banks deposited in banks outside of the United States.

[20] Although the change in hedging strategies from swaps to put options occurs in each of the expert's models, the expertise associated with this idea rests exclusively with Dr. Losey. While Dr. Kaplan incorporated the same concept into his model, he acknowledged that his understanding of Euro-dollar CD put options was limited to only a general familiarity with the subject.

Plainly put, without the assumed change in hedging strategies, the bank would not have survived.

The troubling point about the proposed change in hedging strategies is that at the time the bank is assumed to make this move—sometime in the first quarter of 1990—the bank's investment committee could not have foreseen the direction in which interest rates would move; hence, they could not have foreseen the magnitude of the payout (the interest rate differential) that the swap contracts would ultimately have required. Given this fact, the question that must be answered is this: Is the change in interest rate hedging strategies that the models propose legitimately justified on the basis of economic fundamentals in place in the first quarter of 1990, or is that change simply the inspiration of hindsight?

Put options, we should say at the outset, are not inherently lower in cost than swaps, nor do they offer a more efficient interest rate risk-management tool. Rather, swaps and put options are essentially different approaches to the same problem. In a swap, the bank, as the fixed-rate payer, trades away the risks associated with the variability of the short-term interest rate in favor of the certainty of a fixed payment; in a put option, on the other hand, the bank avoids the burden of a fixed-rate payment but assumes the short-term risk. Because of this difference in focus, swaps, on average, are more efficient, *i.e.*, provide better protection at lower cost, than puts in a rising interest rate environment and, conversely, are less efficient than puts in a declining interest rate environment.

With these thoughts in mind, we come to the reasoning that was offered in support of the assumption that

the bank would buy out its swap commitments in favor of relying on put options as its primary hedging mechanism. Two principal reasons are given in support of the change—the first offered by Dr. Losey; the second by Robert Wages, a Castle Harlan employee responsible for much of the preliminary analyses leading up to the acquisition of the bank. Although Dr. Losey gave a number of reasons to justify the change in hedging strategies, his core thought was this: that the deterioration in the bank's net worth that had occurred during 1989, coupled with the downward trend in interest rates that seemed to have taken hold, would have prompted the bank to reexamine the wisdom of remaining in swaps. The bank, Dr. Losey contended, would have come to see that swaps commanded too large a share of the bank's income and therefore significantly diminished the likelihood of its achieving profitability. Dr. Losey's view is best set forth in his answer to the question of how he thought John Castle might respond to the situation the bank found itself in at the start of 1990: "I think when he saw what had happened to the market and saw that the profits of the institution had declined significantly and that their market value of net worth had declined significantly, that logically at least, he would have been aware that the put options gave the institution a significantly better chance of turning around, of improving its situation."

An alternate rationale for the assumed change in hedging strategies was provided by Robert Wages. In his view, the bank's decision-making process would have been guided by the same considerations that Castle Harlan took into account when examining hedging strategies in respect to the investment funds Castle

Harlan itself managed. That decision, he explained, is guided by the spread between long and short-term interest rates. Specifically, when long-term rates exceed short-term rates-a situation referred to as the "normal yield curve"—the preference is to avoid a fixed-rate payment obligation; hence, put options become the strategy of choice. Conversely, when short-term rates equal or exceed long-term rates-a situation referred to as a "flat" or "inverted yield curve"—there is more of an incentive to pay, rather than to receive, a fixed rate; hence, swaps are favored. Mr. Wages summed up his views this way: "It only makes sense to move away from swaps when you have an upward sloping yield curve and the difference in the short rate and the long rate is wide enough that over the course of a year or some period of visibility you might want to look at, if rates stay where they are, that you're going to get a payback on the premium you pay up front for the option .... [M]y experience is that you normally need to have at least 100 basis point difference between short rates and long rates before it makes sense to look at getting out of the swap."

On the face of it, the views expressed by Dr. Losey and Mr. Wages would seem to offer imminently reasonable grounds for pursuing a change in hedging strategies. But this court's task is not to judge whether a given proposition is reasonable in its own right. It is, rather, to decide whether that proposition, when offered as a prediction of a likely future occurrence, has enough experience behind it to permit a court to say that the predicted event is one reasonably certain to occur. And that level of proof, as we said earlier, is achievable only through external verification. We must be able to find

confirmation of the proposition at stake either in the history of the undertaking or in the nature of the subject at issue. We do not encounter that level of assurance here.

Not surprisingly, there is nothing in the bank's brief operating history that would help support the assumed change in hedging strategies. Swaps, rather than put options, served as the bank's primary hedging device throughout 1989. Nor do we find much guidance in the risk management policies and procedures that the bank had adopted. Granted, these in-house guidelines do acknowledge that "[i]nterest rate swap agreements will be offset or sold if the desired hedging goals can be met in a cheaper or more efficient manner by utilizing another hedging strategy." However, the probative value of this statement is tempered by the fact-as further noted in the same in-house guidelines-that the bank's general requirement is for a hedging strategy that will produce gains as rates increase and that such hedges "[u]sually . . . will produce losses as rates decrease." Based on this statement, we can rightfully say that the bank was aware from the start of the downside risks associated with the use of swaps but elected to rely upon them nevertheless.

The absence from the bank's operating history of any changes in hedging strategy of the sort now being contemplated, while disadvantageous to plaintiffs' position from a burden of proof standpoint, is certainly not fatal. Even in the absence of confirmatory past conduct, plaintiffs could still prevail in their position—*i.e.*, establish the proposed change in interest rate hedging strategies to a degree of reasonable certainty-if the economic fundamentals in place in the first quarter of 1990 (the time the change is assumed to occur) convincingly demonstrate the wisdom of such a move.

Both Dr. Losey and Mr. Wages did, in fact, focus on such fundamentals. To recall, Dr. Losey saw the change to put options as a means of arresting the dollar outflow that the swap agreements were imposing on the bank in late 1989, and which, if not abated, would have driven the bank into insolvency. Essentially the same thought was expressed by Mr. Wages. His view was that a change in hedging strategies would be warranted when the interest rate yield curve returned to its normal configuration—when long-term rates became higher than short-term rates—and the spread between the two rates reached roughly 100 basis points, *i.e.*, one percent. (In this environment, each 100-basis point spread between long and short-term rates would impose a $1.8 million outflow on the bank if it remained with the swaps up to the full notional amount of $180 million.)

No doubt, these arguments have substance. But they do not go far enough. The problem each presents is this: the change in hedging strategies—from swaps to put options—was not an expense-free undertaking. Were that change-over to have been carried out in the first quarter of 1990, as the experts' models assume, it would have cost the bank $3.1 million dollars—the buy-out cost of its fixed-payment obligation under the swap contracts. To justify an expense of this magnitude—one which, in essence, amounts to a very large bet in favor of a sustained downward movement in short-term interest rates—the bank would have been obliged, by the terms of its risk management policies and procedures, to have analyzed its interest rate risk and determined, through

such analysis, that a change to Euro-dollar CD put options reduced that risk.[21]

No such analysis accompanied the experts' models. Instead, we were told by Dr. Losey that the change in hedging strategies was, in part, justified by the decline in short-term interest rates that was occurring throughout 1989. But that decline, as Dr. Losey himself recognized, was simply part of a longer term trend of falling interest rates that had been ongoing "since Paul Volker jacked interest rates up in 1980-81." In other words, the trend was as much apparent in early 1989, when the bank first entered into its five-year swap agreements, as it was in early 1990, when the relinquishment of swaps in favor of put options is assumed to occur.

And, just as the bank had chosen to rely on swaps as its primary hedging strategy despite a prevailing downward trend in interest rates, so too did it make that

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[21] Some sense of the magnitude of this bet may be gleaned from the fact that, if short-term interest rates were to rise to 9.63 percent (the strike price assumed in Dr. Losey's model) and remain at that level, then the bank, using at-the-money put options (*i.e.*, options with a strike price of 9.63 percent), would have had to reestablish its hedge every six months at a cost, to start with, of $2.8 million. For each subsequent six-month period, the cost of renewing the put options would have declined by $279,000 reflecting the shortening maturity of the bank's high-yield bond portfolio.

As a point of reference, we show here the monthly short-term interest rates that prevailed in 1989: January-9.38%; February-10.31%; March-10.31%; April-9.94%; May-9.56%; June-9.31%; July-8.56%; August-9.00%; September-9.19%; October-8.69%; November-8.50%; and December-8.38%.

choice despite the fact that, over the five-year term of the swap contracts, the bank could reasonably have anticipated the prevalence of a normal yield curve. Hence, the likelihood of incurring a net expense over the life of the swaps would have been an expected outcome. Thus, as the court sees it, the reasons that Dr. Losey and Mr. Wages offered in support of a change in hedging strategies were reasons that the bank could reasonably have been expected to take into account at the time the swap contracts were executed. In short, those reasons make out no case for a change in hedging strategies-at least not one that this court can now endorse under the criterion of reasonable certainty.

We do not mean to say that the bank would forever remain wedded to its swap contracts. Rather, our point is only that one cannot say with reasonable certainty that the bank would have been so quick to jettison the swap contracts in favor of put options-having experienced only four months of negative interest rate payments, all of which were foreseeable from the inception of those contracts-and, at the same time, incur a $3 million expense as the price of doing so.

Indeed, the testimony itself lends force to our concern about the timing of a change. In Dr. Losey's model, for example, the assumption is that the bank would close-out its swap contracts in January 1990. According to Mr. Wages, however, the more likely exit time would have been in the March-April 1990 period when the spread between long and short-term interest rates first crossed the 100 basis-point threshold. (There was also testimony to the effect that the bank would have been prompted to make at least a partial change to put options in February 1990 because of the bankruptcy

of Drexel Burnham Lambert, Inc., a brokerage firm that was the counterparty on approximately one-third of the bank's $180 million in swap contracts.)

We cannot, of course, be certain when the change would have occurred or, for that matter, whether it would have occurred at all. This much, however, is clear: the timing is critical to the sufficiency of the $10 million capital infusion that the experts' models assume. The cost to exit the swaps at any time after the end of the first quarter of 1990 begins to rise dramatically from the low point of $1.8 million (at the end of March) to $8.4 million by year's end. (And, after 1990, with the continuing decline in interest rates, the exit costs become even larger.) The upshot, then, is this: to effect the change in hedging strategy at any time other than during the predicted first quarter of 1990 would have demanded substantially more money from the bank's investors.

The last point brings us now to our final thought on the issue of reasonable certainty. Throughout the course of these proceedings, plaintiffs have urged the court to view the experts' models as depictions of a reasonably probable course of events rather than as forecasts of certainty. In keeping with that approach, we have been asked to recognize that, had the bank been permitted to operate in the post-FIRREA world, the capital infusion it would actually have required might either have been less or, if necessary, more than the $10 million that the models assume. Therefore, the thought continues, to the extent the court is unable to accept some of the models' cost assumptions (as, in fact, is the case with regard to the expenses identified with the commercial real estate portfolio and the change in hedging strategies), we

should at the same time recognize that the investors would be willing and able to address any resulting capital shortfall.

The court has, in fact, approached the evaluation of the experts' models with the degree of flexibility that reasonableness would demand of any prediction regarding future events and circumstances. Pinpoint accuracy has not been our expectation. In that spirit, we accept the premise that the investors would not have allowed the bank to fail if the capital infusion actually required had turned out to be, say, $11 million instead of the assumed $10 million.

But that flexibility in approach has its limits. The court cannot simply assume that whatever capital shortfall might occur, the investors would have been willing to make up the difference. At the start of the undertaking, the Castle Harlan group projected a growth in stockholders' equity from $12.0 million to $147.4 million over an eight-year period. This equates to an average annual return of 36.8 percent. However, with the addition of another $10 million to the capital base (the assumed capital infusion), the average annual rate of return is reduced to 26.8 percent. Thus, to have approached the experts' models with that degree of latitude in judgment now being asked of us, the question that needed to be answered—but was not—is how much more the investors would have been willing to put into the venture before reaching their tipping point, *i.e.*, before the market could be seen as offering more attractive investment opportunities elsewhere. The experts never took on this essential question.

In the final analysis, then, even if we could quantify the extent of our disagreement with the experts' cost as-

sumptions, we could not go on to the next step: to say with the confidence that reasonable certainty demands that the investors would have been willing to make up the difference. We end on that note.

Dr. Losey's Alternative Damages Calculation

In addition to his lost profits model, Dr. Losey offered an alternative damages calculation that attempted to establish a value for the contract measured as of the date the contract was signed. Using this *ex ante* approach, Dr. Losey focused on what he considered to be the chief component of value in the bank's contract—its right to the leveraged purchasing of high-yield bonds, using, as a principal source of funds, lower-cost government-insured deposit accounts. ($15 million of capital could support a $263 million bond portfolio.)

In determining the value of this right, Dr. Losey relied on three factors: (i) a projected volume or dollar amount of high-yield bonds that the bank would eventually acquire; (ii) an assumed spread between high-yield bond rates and the bank's cost of funds (adjusted for expected defaults and other related expenses, including the costs associated with the management of interest rate risk, *i.e.*, the cost of hedging strategies); and (iii) a discount factor to determine present values. Using this methodology, Dr. Losey determined that, as of the date of contracting, the year-end 1988 value of the bank's right to acquire and hold high-yield bonds was approximately $31.1 million. This figure, Dr. Losey further explained, would vary only slightly if measured as of the date of the breach rather than the date of the contract.

We cannot accept this approach. Expectancy damages, as the Restatement points out, are "not based on

the injured party's hopes when he made the contract but on the actual value that the contract would have had to him had it been performed. . . . It is therefore based on the circumstances at the time for performance and not those at the time of the making of the contract." Restatement § 344 cmt. b. Dr. Losey's *ex ante* approach is fundamentally out of line with this rule and therefore cannot be endorsed.

However, even if contract law could accommodate a damages analysis of the present sort, we would still find its particular application here unacceptable. Both the narrowness of Dr. Losey's focus (the *ex ante* approach addresses only the high-yield bond portfolio without regard to the other components of the bank's business) and the paucity of detail that he builds on, would compel us to reject this approach for lack of substantive reliability. Indeed, the approach is not much more than an outline of damages.

Restitution Interest

We proceed now to the second theory of recovery on which plaintiffs rely: restitution. In contrast to expectation damages which seek to put an injured party in as good a position as he would have been in had the contract been performed, restitution serves as an alternative remedy for breach that attempts to return an injured party to the position he was in before the contract was formed. Restatement § 373 cmt. a. Thus, restitution focuses on disaffirmance of the contract as opposed to its enforcement.

The rationale that guides the application of restitution in the contractual setting has been alternately described. The Restatement, for example, relates the pro-

tection of a party's restitutionary interest to "the prevention of unjust enrichment." Restatement (Second) of Contracts (Introductory note preceding § 370). Case law, on the other hand, puts its focus on restoration of the parties' status preceding the contract's execution. *See Acme Process Equip. Co. v. United States*, 171 Ct. Cl. 324, 347 F.2d 509, 530 (1965), *rev'd on other grounds*, 385 U.S. 138 (1966) ("[R]estitution is permitted as an alternative remedy for breach of contract in an effort to restore the innocent party to its pre-contract *status quo*, and not to prevent the unjust enrichment of the breaching party."); *Resolution Trust Corp. v. Federal Sav. & Loan Ins. Corp.*, 25 F.3d 1493, 1504 (10th Cir. 1994) ("The purpose of . . . restitution is to put the plaintiff in as good a position as it enjoyed before the contract was made by requiring the defendant to restore the value of plaintiff's part performance or reliance."). Irrespective of doctrinal orientation, however, the essential requirement for the recognition of a restitutionary remedy is that a benefit have been conferred: "A party is entitled to restitution . . . only to the extent that he has conferred a benefit on the other party by way of part performance or reliance." Restatement § 370.

Consistent with this requirement, plaintiffs' advance three restitutionary formulas, each centered on a benefit allegedly conferred on the government. The first, which they refer to as the "cost of performance," seeks recovery of the approximately $15.1 million that was used to recapitalize the bank at the outset of the venture. The second, which they caption "the initial benefit conferred," rests on the assumption that the benefit conferred is most appropriately measured by the costs which the government avoided as a result of plaintiffs'

take-over of the bank. (In this context, the term "avoided costs" refers to the costs which the government is presumed to have saved by not having to liquidate the bank.) As of the end of 1988, the costs avoided are claimed to be $20.75 million.

The third of the restitutionary formulas plaintiffs would have us consider is one they refer to as "the total benefit conferred." This approach is the sum of three components: plaintiffs' initial capital contributory transaction costs); the bank's earnings from date of take-over, January 1989 until February 1990 ($8.24 million per plaintiffs' calculation); and the investment earnings (*i.e.*, interest) which the government presumably realized from the liquidation costs avoided over the thirteen-month period of plaintiffs' management of the bank ($13.74 million per plaintiffs' estimation). The sum of these numbers comes to roughly $35.6 million. Plaintiffs assert that, in accordance with accepted principles of restitution, they are entitled to an award of the highest of the three amounts identified above.

In the court's view, plaintiffs are entitled to restitution in the amount of their original investment-$15,122,360. We come to our conclusion by several steps. First, as already noted, restitution as a contract remedy requires that a benefit have been conferred. In determining whether a benefit has been conferred, we look to the terms of the agreed exchange: "[t]he benefit is ordinarily conferred by performance by the party seeking restitution, and receipt by the other party of performance that he bargained for is regarded as a benefit." Restatement § 370 cmt. a. In this case, what the government bargained for and received was an infusion of capital into an ailing bank and the subsequent operation

of that bank in accordance with an approved business plan. The government got what it bargained for; hence, restitution is available.

Second, where restitution is to be accomplished through an award of money (as opposed to speck restitution), the value of the benefit conferred may be measured either by its market value—"what it would have cost [the recipient] to obtain it from a person in the claimant's position," Restatement § 371(a)—or by its enrichment value "the extent to which [the recipient's] property has been increased in value or his other interests advanced." Restatement § 371(b). Under neither of these standards, however, would it be appropriate to measure the value of the benefit conferred by expenditures the recipient may have avoided as a result of the transfer. Such collateral advantages, while they may derive from the benefit conferred, still are not part of it. Fundamentally, restitution is a restorative remedy—one that seeks to return to the giver the reasonable value of what was given. The remedy's focus is upon the diminution in value of the injured party's estate. Restitution does not permit the injured party to expand the value of the benefit conferred beyond the amount for which that benefit could have been acquired in the market place. *See* Restatement § 371 cmt. b, illus. 2; 5 Corbin, Contracts § 1112 (1964 & Supp. 1999).

Finally, in determining the amount of plaintiffs' restitutionary award, it does not matter that, at the time the breach occurred, the bank was worth less than the amount plaintiffs had initially contributed. Nor is it significant that the costs to liquidate the bank in 1990 were greater than those costs would have been had the liquidation been carried out in 1988. Given the limited time

plaintiffs had available before the breach in which to prove the merits of their business plan, the bank's subsequent operating history is irrelevant. Plaintiffs are entitled to the value of the benefit they conferred, measured as of the time their performance took place. 1 George E. Palmer, The Law of Restitution § 4.2, at 372 (1978).

In accordance with the foregoing discussion, plaintiffs are entitled to an award in restitution of $15,122,360—the amount they contributed to the capital of the bank.

In addition to requiring the return of plaintiffs' $15.1 million capital contribution, the court has also considered the question of whether they may recover interest on that amount. Restitution, properly administered, would certainly favor such a result, for only through the addition of interest can we truly restore plaintiffs to the economic position they were in before the contract was executed.

Despite the appropriateness of allowing interest as part of the award, however, statutory constraints compel us to withhold that additional measure of restitution. The relevant statute, 28 U.S.C. § 2516(a) (1994), states in unequivocal terms that "[i]nterest on a claim against the United States shall be allowed in a judgment of the United States Court of Federal Claims only under a contract or Act of Congress expressly providing for payment thereof."

We cannot avoid the barrier of the statute by identifying interest as part of the judgment as opposed to interest on the judgment. The prohibition extends to any form of award for the time value of money that has not

been authorized by the express terms of the transaction sued on. *United* States *v. Mescalero Apache Tribe*, 207 Ct. Cl. 369, 518 F.2d 1309, 1315-21 (1975), *cert. denied*, 425 U.S. 911 (1976); *Far* West *Fed. Bank v. OTS*, 119 F.3d 1358, 1366 (9th Cir. 1997). Plaintiffs' recovery in restitution cannot, therefore exceed the $15.1 awarded.

Fifth Amendment Taking

Having adjudicated plaintiffs' contract claims, we turn finally to the third of plaintiffs' counts: a claim for the recovery of just compensation under the Fifth Amendment to the United States Constitution. Specifically, and in the alternative to their contract-based claims, plaintiffs contend that the passage of FIRREA effected a taking of both their ownership interest in Western Empire and their contractual agreement with the government?[22] In response, defendant argues that the only rights and remedies available to plaintiffs are those arising from their contract. Thus, in defendant's view, the sole right plaintiffs possess is the right to monetary damages in the event of contractual nonperformance, and the sole remedy open to them is for breach of contract.

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[22] As previously mentioned, plaintiffs have urged us to address their taking claim despite our having ruled on their contract-based claims. Because of the significance of that issue, and in the interest of judicial economy, we have complied. *Sun Oil Co. v. United States*, 215 Ct. Cl. 716, 572 F.2d 786, 817-818 (1978); *Chandler v. Hibberd*, 165 Cal. App. 2d 39, 332 P.2d 133, 140 (1958).

Plaintiffs are of course correct in their assertion that contracts-including those with the federal government-constitute property rights within the meaning of the Fifth Amendment. *Lynch v. United States*, 292 U.S. 571, 579, (1934) ("Rights against the United States arising out of a contract with it are protected by the Fifth Amendment."). Where the government so interferes with an individual's contract rights as to effectuate a taking, it cannot avoid the payment of just compensation. But as this court and its predecessor court have held, "the concept of a taking as a compensable claim theory has limited application to the relative rights of party litigants when those rights have been voluntarily created by contract. In such instances, interference with such contractual rights generally gives rise to a breach claim not a taking claim." *Sun Oil Co. v. United* States, 215 Ct. Cl. 716, 572 F.2d 786, 818 (1978) (citation omitted).

In defendant's view, a plaintiff cannot pursue a takings claim for a government action that interferes with property rights, where those rights were voluntarily created by contract. *Sun Oil*, *supra*, is cited in support of this proposition. In contrast, plaintiffs interpret *Sun Oil* as standing for the principle that a breach of contract claim is the exclusive remedy when the government has acted solely in its proprietary capacity (as contractor), but that a takings claim may be pursued when the government has exercised its sovereign authority. After a careful consideration of the relevant caselaw, we conclude that neither side's interpretation fully answers the question at hand: whether plaintiffs in fact have a property right that has been taken.

The difficulty with defendant's position is that a litigant may indeed maintain a takings action even where

its rights have been created exclusively by contract. *Lynch v. United States*—a case in which the plaintiff was eligible for just compensation when its contractually created right to war risk insurance was abrogated by statute—offers us an example. Similarly, while plaintiffs may be correct that a sovereign act is a prerequisite to invoking the Takings Clause,[23] that observation does little to answer whether anything has in fact been taken. *Branch v. United States*, 69 F.3d 1571, 1575 (Fed. Cir. 1995) ("In analyzing a takings claim, a court must first determine what was taken.").

In the oft-repeated words of *Armstrong v. United States*, 364 U.S. 40, 49 (1960), the Fifth Amendment is designed "to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." At its core, the Fifth Amendment provides a guarantee that the government will neither contravene the settled expectations that make up the essence of property rights nor dramatically diminish property values without paying just compensation. Whether a taking has occurred therefore depends on the nature and scope of the property right at stake.

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[23] To the extent that the case law draws a distinction between proprietary and sovereign acts, that dichotomy becomes less meaningful in light of the Supreme Court's pronouncement in *Winstar* that "the inescapable conclusion . . . is that the Government's 'regulatory' and 'nonregulatory' capacities were fused in the instances under consideration, and we suspect that such fusion will be so common in the modern regulatory state as to leave a criterion of 'regulation' without much use in defining the scope of the sovereign acts doctrine." *Winstar*, 518 U.S. at 894.

In the present case, any rights the plaintiffs possess were conferred on them by contract. But as Justice Scalia's concurring opinion in *Winstar* makes clear, the formation of a contract does not entitle its signatories to absolute performance, but rather gives rise to the expectation either that the contract will be performed or that the non-breaching party will have available to it a contract-based remedy. "Virtually *every* contract operates, not as a guarantee of particular future conduct, but as an assumption of liability in the event of nonperformance. The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, and nothing else." *Winstar*, 518 U.S. at 919 (Scalia, J., concurring) (citing Holmes, The Path of the Law (1897), in 3 The Collected Works of Justice Holmes 391, 394 (S. Novick ed. 1995)).

The savings & loan plaintiffs, the *Winstar* Court concluded, have no absolute right to the regulatory treatment specified in their contracts, but only a right to be compensated should that regulatory treatment be altered. The government was thus free to impose new requirements on Western Empire, so long as it insured the bank against the losses associated with that change. *See Winstar*, 518 U.S. at 870. Because the present plaintiffs have available, and indeed have successfully pursued, contract-based claims, plaintiffs' expectations with regard to their property interests have not been contravened and the value of those interests have not been diminished. Accordingly, we are unable to conclude that plaintiffs have suffered a taking.

Plaintiffs argue, however, that the cases on which they chiefly rely—*Lynch*, 292 U.S. 571; *Prudential Ins. Co. v. United States*, 801 F.2d 1295 (Fed. Cir. 1986);

and *Cleveland Bd. of Educ. v. Loudermill,* 470 U.S. 532 (1985)—require us to reach a different conclusion. Yet, none of those cases challenges the basic principle that a litigant to whom a contract remedy is available has not been deprived of the rights conferred on him by contract. In *Lynch*, for instance, the plaintiff was eligible for just compensation because the right to the proceeds owed her as beneficiary under a government-issued war-risk insurance contract was abrogated by statute, leaving that plaintiff without recourse to a breach of contract claim. Indeed, the government in *Lynch* defended on the ground that the court had no jurisdiction since plaintiff's rights had essentially been eliminated.[24] *Lynch*, 292 U.S. at 575.

Similarly, plaintiffs direct our attention to *Prudential Ins. Co. v. United States*, 801 F.2d at 1300 n.13, in which the court observed that a landlord suing for the government's breach of a leasing contract (the government had failed to quit the premises at the end of the lease term) "may have an alternate avenue of relief under the Takings Clause of the Fifth Amendment." Resort to the takings clause in that example, however, was warranted by the fact that the landowner had rights in the property separate and from any rights conferred by

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[24] Other courts have characterized the *Lynch* holding as standing for the proposition that a taking occurs when the government "repudiates debts to save money." *Buse Timber & Sales, Inc. v. United States*, 45 Fed. Cl. 258, 263 (1999). Because a refusal to pay money owed under a contract essentially deprives a litigant of any contractual remedy (since a contract, by definition, is an agreement to pay money in the event of breach), we endorse the view that such a scenario constitutes a taking.

contract. The principle that the right is intact so long as the remedy is available simply does not apply to rights that exist independent of a contract.

Nor does *Cleveland Bd. of Educ v. Loudermill* support plaintiffs' position. The question presented in that case was whether the discharge of a public employee in accordance with the procedures applicable to his position where those procedures afforded the employee neither an opportunity to respond to the charges against him nor the right to challenge his dismissal. In rejecting the state's contention that the employee's property right in his position was limited by the procedures afforded for its protection, the court repeated what it had earlier said in *Arnett v. Kennedy*, 416 U.S. 134, 167 (1974): "While the legislature may elect not to confer a property interest in [public] employment, it may not constitutionally authorize the deprivation of such an interest, once conferred, without appropriate procedural safeguard." *Loudermill*, 470 U.S. at 541. The Constitution's requirement of due process, the Court went on to say, demanded that the employee be given an opportunity to address the charges made against him before his discharge became effective. *Id.* at 547-48.

Plaintiffs argue that *Loudermill* poses a direct parallel to our case. In the same way that an employee with a property interest in his position may not be deprived of that position may not be deprived of that position without observance of the protections without observance of the protections assured by the Due Process Clause of the Constitution, plaintiffs contend, so neither may a party with a property interest in his contract be deprived of the value of that contract without payment of the just compensation assured by the Takings Clause of the Constitu-

tion. And since, in plaintiffs' view, the remedy for a governmental taking is not provided by statute (or the common law of contract), but rather the Constitution itself, the question of what compensation is just cannot be resolved by reference to an external source of the remedial law but rather by the plain terms of the Fifth Amendment.

Plaintiffs are correct that the Takings Clause—like the common law right to damages—forms the backdrop against which contractual relationships are created. They are equally correct that constitutional protections can be neither contracted away nor otherwise waived. That is not to say, however, that by rejecting the existence of a taking, we are somehow denying plaintiffs a larger, extra-contractual protection afforded by the Constitution. *Loudermill*, in our view, simply stands for the proposition that the Constitution provides a minimum level of protection to property rights, and that resort to a constitutional remedy is appropriate when the state has infringed on those rights. As discussed above, the Takings Clause would be implicated in the present case if the government had taken away the range of remedies associated with the vindication of a contract. That it has not done.

We turn then to two of plaintiffs' contentions that we believe merit additional attention. The first is the assertion that if plaintiffs recover less than "just compensation" (*e.g.*, because the court denies lost profits or because contract damages cannot include pre-judgment interest), the Fifth Amendment requires the government to make up the difference. The second is that the seizure of the bank itself represents a per se taking, quite apart from any taking of contract rights.

As to the first assertion, plaintiffs' rule proves too much. If we were to characterize as a taking the failure to award pre-judgment interest on a contract claim, we would essentially invalidate the law's proscription against the allowance of pre-judgment interest when not specified by contract or congressional act. 28 U.S.C. § 2516(a). Further, the congressional waiver of sovereign immunity only in those instances where interest is specifically provided for by contract or congressional act means that, in the absence of those circumstances, plaintiffs have no reasonable expectation—and hence no property interest—in the money they might otherwise have earned as interest on an earlier-paid judgment.

Similarly the court's refusal to award lost profits does not transform plaintiffs' loss into a taking. As discussed earlier, the court was not reasonably convinced that profits would have existed, so the failure to award them in no way diminishes the value of plaintiffs' contract rights.

As to the second assertion, we see no reason to contemplate a taking that does not involve the taking of contract rights. The law is clear that the seizure of a bank that fails to meet regulatory capital requirements does not constitute a taking. *See Branch*, 69 F.3d at 1575 ("The seizure and closure of the bank, once the bank became insolvent, did not constitute a taking."). While plaintiffs attempt to distinguish *Branch* on the ground that their contract afforded them a legitimate expectation that the laws governing the thrift would not change, the *Winstar* decision makes clear that plaintiffs had no entitlement to a specific regulatory treatment as distinguished from the entitlement to damages in the

event of regulatory change. *Winstar*, 518 U.S. at 868-870.[25]

Finally, because we hold that no property right has been taken, we do not reach the question, posed by the FDIC, of whether the private plaintiffs or the receiver should properly be considered the owner of the property right at stake.

CONCLUSION

After more than ten years of litigation and four full months of trial, we now reach the end of plaintiffs' tenure before this court. While plaintiffs presented a strong and exceedingly well-argued case on behalf of their

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25 There the Court wrote:

> It is important to be clear about what these contracts did and did not require of the Government. Nothing in the documentation or the circumstances of these transactions purported to bar the Government from changing the way in which it regulated the thrift industry. Rather, what the Federal Circuit said of the Glendale transaction is true of the Winstar and Statesman deals as well: "the Bank Board and the FSLIC were contractually bound to recognize the supervisory goodwill and the amortization periods reflected" in the agreements between the parties. We read this promise as the law of contracts has always treated promises to provide something beyond the promisor's absolute control, that is, as a promise to insure the promisee against loss arising from the promised condition's nonoccurrence. . . . Restatement (Second) of Contracts § 264, Comment a. "Such an agreement," according to the Restatement, "is usually interpreted as one to pay damages if performance is prevented rather than one to render a performance in violation of law."

claim for lost profits, we were ultimately unable to conclude that the events depicted in the models were sufficiently rooted in the real-world experiences of the bank to allow us to accept either the existence of damages or the amount of damages with any reasonable degree of certainty. Without that minimum guarantee of reliability, we were thus forced to conclude that plaintiffs' bid for lost profits must fail.

Nor, in the end, could we accept plaintiffs' contention that they have suffered a Fifth Amendment taking. Plaintiffs' contract entitled them to the very contract remedies they have come here to pursue-remedies which now afford them recovery in restitution of $15.12 million. Plaintiffs have been deprived of neither a property right nor a contract right.

Finally, we conclude that although the FDIC is the proper party to prosecute the bank's breach of contract claim, that authority does not extend to claims for money owed the government by the government. In addition, the award in restitution, essentially returning plaintiffs to their pre-contract position (without, of course, the not insubstantial benefit of the interest that would have been made on those sums) should be awarded directly to the shareholder-plaintiffs, and not to the FDIC.

For the reasons stated, the clerk is directed to enter judgment (i) granting the shareholder-plaintiffs restitution in the amount of $15,122,360 and (ii) dismissing the complaint of the plaintiff-intervenor, the Federal Deposit Insurance Corporation.

ORDER DENYING PETITION FOR RECONSIDERATION

On November 27, 2000, defendant filed a petition pursuant to Rules 52(b), 59(a)(1) and 60(b)(6) of the court's rules seeking reconsideration of that part of our November 9, 2000 decision upholding the FDIC's standing to pursue breach of contract damages on behalf of Western Empire Savings and Loan Association—a failed thrift institution. Specifically, defendant contends that, in its capacity as manager of the FSLIC Resolution Fund, the FDIC is not invested with the powers of a receiver and thus lacks authority to assert any claim in a representative capacity. Additionally, defendant raises again an earlier-presented argument: that an action brought by the FDIC in this court—even if otherwise permissible—would amount to an intra-governmental dispute and hence be ineligible for adjudication on that ground alone.

The request for reconsideration lacks merit. Title 12 of the United States Code, section 1821a(a)(4)(1994) states that "the Corporation [the FDIC] shall have all rights, powers, and duties to carry out the Corporation's duties with respect to the assets and liabilities of the FSLIC Resolution Fund that the Corporation otherwise has under this chapter." Among the powers which the FDIC "otherwise has under this chapter" is the power "to act as receiver." 12 U.S.C. § 1819(a). *See also* 12 U.S.C. §§ 1821(c), 1823(d)(3). Accordingly, there can be no doubt that in the proper discharge of its duties as manager of the FSLIC Resolution Fund, the FDIC can—indeed must—discharge the fiduciary responsibilities owed by a receiver to the creditors of a failed financial institution.

Nor can there be any doubt that, in pursuing the discharge of these duties through the filing of a breach of contract action in this court, the FDIC is not embarking upon an intra-governmental dispute. A recovery on such a claim would have been exclusive of the so-called receivership deficit claim; hence any recovery would have been for the benefit of general creditors and shareholders and not for the benefit of the United States or any agency thereof.

The petition for reconsideration is denied.

APPENDIX C

In the United States Court of Federal Claims

John K. CASTLE, *et al.*,

Plaintiffs

and

Federal Deposit Insurance Corporation, as Successor to the Rights of Western Empire Savings and Loan Association,

Plaintiff Intervenor,

v.

The UNITED STATES,

Defendant.

United States Court of Federal Claims

No. 90-1291C

Feb. 2, 1999

OPINION

Smith, Chief Judge:

INTRODUCTION

This case is before the court on the parties' cross-motions for summary judgment as to liability and on defendant's partial motion to dismiss certain named plain-

tiffs. The private plaintiffs in this action contend that they had a contract with the government, through the Federal Home Loan Bank Board (FHLBB), to acquire and recapitalize Western Empire Savings and Loan Association (Western Empire) in 1988 in exchange for particular regulatory treatment. Plaintiffs contend that critical components of the contract were breached by the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183, and by the promulgation of its implementing regulations. The thrift was ultimately seized by the government in February 1990. Plaintiff-intervenor Federal Deposit Insurance Corporation (plaintiff FDIC) has brought suit, as the successor in interest, on behalf of the failed thrift.

This case has proceeded under the case management process instituted to manage the so-called *Winstar*-related cases in the wake of the United States Supreme Court's decision in *United States v. Winstar*, 518 U.S. 839 (1996). As such, the court has considered two additional waves of briefing related to this case in resolving the pending motions. First, the court ordered, at the end of its opinion in *California Federal Bank, FSB v. United* States, 39 Fed. Cl. 753 (1997) that the government show cause why summary judgment should not be entered in cases, such as this one, where motions for summary judgment as to liability were pending. The court subsequently ordered a series of responsive briefs as part of this show cause process, and the court has considered those briefs in resolving the pending motions. Second, the court ordered supplementary briefing on Common Issue 11, which dealt with the standing of various investor plaintiffs to sue for breach of contract.

The court selected five cases, including this one, to frame and fully ventilate Common Issue 11, and the process culminated in oral argument on the Common Issue on July 7, 1998. As with the show cause briefing, the court has considered fully the supplementary Common Issue briefing in resolving the pending motions.

As a result of the show cause process, the parties agreed that two issues were left unresolved by the court's opinion in *California Federal*, and defendant and the plaintiffs disagreed as to whether another issue was resolved or not by that opinion. The parties agreed that the status of certain plaintiffs to maintain direct breach of contract actions—the subject of the government's motion to dismiss—was not resolved by *California Federal.* The parties further agreed that defendant's affirmative defense of prior material breach was left unresolved by the court's, opinion. The parties disagreed as to whether defendant's grounds for summary judgment—that the agreement expressly assigned the risk of regulatory change to plaintiffs, meaning that the passage of FIRREA could not have breached any contract between the parties (the so-called "successor regulation" argument)—was resolved by the *California Federal* opinion. Because the court agrees that defendant's argument is not foreclosed by the *California Federal* opinion, the court will examine defendant's argument in light of the contractual documents relevant to this transaction in this case.

For the reasons set forth below, the court denies defendant's motion for summary judgment and its alternative motion to dismiss certain named plaintiffs, and grants the motions of private plaintiffs and plaintiff intervenors for partial summary judgment as to liability.

BACKGROUND

In this case, the parties agree as to many facts which will be recited here unless disputed. In December 1988, plaintiffs John K. Castle and Leonard M. Harlan, who headed the venture capital firm Castle Harlan, Inc., entered into an agreement with the FHLBB and the Federal Savings and Loan Insurance Corporation (FSLIC) to acquire Western Empire Federal Savings and Loan (Western Empire). The agreement, as argued by plaintiffs and conceded by defendant, was memorialized in several documents: the Regulatory Capital Maintenance Agreement (RCMA), with Consent Agreement, signed by Messrs. Castle and Harlan, the FSLIC and the President of Western Empire on December 30, 1988; the Acquisition Approval Letter with attached Conditions, issued by the Federal Home Loan Bank Board on December 30, 1988; and the Business Plan, formulated by Castle Harlan in support of the reorganization plan, submitted by Castle Harlan, Inc. prior to the acquisition.

In short, plaintiffs contend that the agreement memorialized in these documents—the terms of which were heavily negotiated by Castle Harlan and the regulators during mid and late-1988 according to the undisputed documentary evidence—worked as follows: Castle Harlan would engineer the recapitalization of the bank in exchange for certain capital forbearances and other contractual promises regarding the regulatory capital rules that would apply to Western Empire. Plaintiffs point to four key promises contained in the documents that plaintiffs contend were breached by the passage of FIRREA.

First, plaintiffs contend that the government promised that Western Empire would be permitted to meet

the lesser of either the standard regulatory capital requirements as set forth in FHLBB regulations, or a Modified Capital Requirement set forth in the Conditions, for a period of five years.

Second, plaintiffs contend that the government promised that Western Empire could include supervisory goodwill in the calculation of its regulatory capital, to be amortized over a period of not more than 20 years.

Third, plaintiffs contend that the government promised that Western Empire could invest up to 25 percent of its assets in high-yield bonds for the first six months and up to 35 percent of its assets in high-yield bonds thereafter.

Fourth, plaintiffs contend that the Conditions contained the promise that, in order for Western Empire to grow its assets as contemplated in the Business Plan, the government promised that for a period of two years Western Empire would not be subject to the normal liability growth restrictions contained in FHLBB regulations.

Defendant does not contest that these provisions were contained in the documents evidencing the agreement. Rather, defendant makes two arguments in support of its motion for summary judgment. First, defendant contends that another provision of the acquisition documents shifted the risk of all future regulatory change onto Western Empire. Second, defendant argues that, to the extent that any plaintiffs have a contract with the government, only two of the plaintiffs—Messrs. Castle and Harlan—even arguably have privity with the government regarding the contract at issue. Accordingly, the government moves to dismiss all but plaintiffs

Castle and Harlan should its motion for summary judgment fail. Lastly, as an affirmative defense to plaintiffs' motions for summary judgment, defendant argues that, even were the court to find that the government owed the promises alleged by the plaintiffs, the prior material breaches by Western Empire and the plaintiffs prior to the enactment of FIRREA relieved the government of the obligation to perform. The court will address each of the arguments in turn.

DISCUSSION

SUCCESSOR REGULATION LANGUAGE

Defendant's motion for summary judgment is premised on language contained in Paragraph 7(c) of the RCMA:

> All reference to regulations of the Bank Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease the Acquiror's obligation under this Agreement.

Defendant contends that this language in the RCMA expressly assigned the risk of regulatory change to plaintiffs. Defendant further cites an 11th Circuit case, *Guaranty Financial Services, Inc. v. Ryan*, 928 F.2d 994 (11th Cir. 1991), which found that virtually identical language as that contained in the Western Empire RCMA shifted the risk of future regulatory change onto the thrift. In what appears to be further support, defendant notes that, in a footnote in the Supreme Court's plu-

rality opinion in *United States v. Winstar*, the Court states:

> To be sure, each side could have eliminated any serious contest about the correctness of their interpretive positions by using clearer language. *See, e.g., Guaranty Financial Services, Inc. v. Ryan*, 928 F.2d 994, 999-1000 (1991) (finding, based on different contract language, that the Government had expressly reserved the right to change the capital requirements without any responsibility to the acquiring thrift).

Winstar, 518 U.S. at 870 n.15. Defendant thus concludes that, because the Western Empire RCMA contains virtually identical language as that found in the *Guaranty* agreement, and given the above-quoted footnote from the Supreme Court's plurality opinion, "the Supreme Court concurred with the Eleventh Circuit's reasoning and holding in *Guaranty*," thus "dictat[ing] a finding that section 7(c) of the RCMA similarly allocated any risk of regulatory change to Western Empire." Def.'s Mot. for Summ. J. and Partial Mot. to Dismiss at 8.

Plaintiffs counter that, when read in the context of the entire agreement between the parties, defendant's interpretation is inconsistent with the plain language of the agreement. Further, plaintiffs argue that, regardless, neither the decision in *Guaranty*, nor the Federal Circuit and Supreme Court *Winstar* decisions, support defendant's argument.

As a preliminary matter, the court notes that neither the Eleventh Circuit opinion in *Guaranty* nor the footnote reference in the Supreme Court's *Winstar* plurality

opinion is directly determinative of the issue in this case. Rather, the most that the court can determine from the defendant's citations are two unremarkable, and, in the realm of contract law, indeed axiomatic propositions. The first is that courts interpret contracts. The second is that clear contract language is easier for courts (and parties) to interpret than unclear language.

As the Eleventh Circuit stated, after determining that the risk of regulatory change fell on the thrift in the *Guaranty* case, in summarizing its conclusions:

> This interpretation, unlike Guaranty's, harmonizes the various provisions of the contract instead of placing them in conflict, and is therefore preferable to Guaranty's reading.

928 F.2d at 999. The Eleventh Circuit states a standard rule of contract interpretation: the court should endeavor to give reading to the contract that "harmonizes the various provisions of the contract instead of placing them in conflict". The Supreme Court's footnote reference to the *Guaranty* decision is put forward, it seems, in support of the idea that clear and unambiguous contract language will allow the parties to make the deal they really want and have it enforced that way. This is a far cry from defendant's conclusion that the footnote reference to the *Guaranty* decision mandates a finding that the successor regulation provision in the Western Empire transaction shifts the risk of all regulatory changes, onto plaintiffs.

Rather, the court must read the successor regulation provision in light of the entire contract between Western Empire and the government, in order to, as the Eleventh Circuit notes in *Guaranty*, "harmonize[] the various

provisions of the contract instead of placing them in conflict." Thus, the mere fact that a similar provision existed, and was relied upon by the court in *Guaranty*, *is* simply not dispositive in this case. Nor is it particularly relevant, unless all the elements comprising the parties' agreement, not just the so-called successor regulation clause, are very similar to those involved in *Guaranty*. As the Eleventh Circuit clearly stated, the successor regulation provision was read in terms of the entirety of the agreement before it. The court must endeavor to do the same regarding the Western Empire transaction, and nothing in the *Guaranty* decision or the Supreme Court's *Winstar* decision counsels otherwise.

Plaintiffs argue that the successor regulation clause can be squared with, and indeed is consistent with, the rest of the agreement. Paragraph 1 of the Conditions for the Approval of Control (Conditions) states:

> 1. (a) The modified computation in (b) below may be used by New Western Empire to calculate the required level of Regulatory Capital in lieu of that which is required under Section 563.13 of the Insurance Regulations . . . .
>
> (b) The Required Regulatory Capital Level may for a period not to exceed *five years* be equal to the lesser of:
>
> (1) The Association's Regulatory Capital Requirement as set forth in the applicable Insurance Regulations in force at any compliance date; or
>
> (2) The Modified Capital Requirement as of any compliance date computed as follows . . .

(emphasis in original). Plaintiffs argue that this provision clearly permits that Western Empire can meet the Modified Capital Requirement in lieu of current or further regulations. Those regulations may change, and they may change in such a way that increases or decreases the obligations of Western Empire. This would happen if, for example, the applicable insurance regulations were lower than the Modified and Capital Requirement, and they were then changed to raise that rate. Under that circumstance, plaintiff would be required to meet the higher rate consistent with Paragraph 1 of the Conditions. Thus, plaintiff argues, the generalized successor regulation provision of the RCMA can be read consonant with the Modified Capital Requirement provision. The successor regulation provision put the parties on notice that regulations "may" change obligations, the argument goes; it does not trump the specific contractual rights set forth to meet capital levels as specified in Paragraph 1 of the Conditions.

Defendant has no real response to this contract interpretation, except to repeat that the successor regulation provision simply shifted the risk of regulatory change to plaintiffs. This, as plaintiffs quite correctly point out, not only is contrary to a plain reading of the contractual terms, but also would render the centerpiece of this agreement absurd. Defendant would have the court accept an interpretation whereby a very specific provision of the agreement setting forth the unique means by which the thrift may meet its capital standards, and designed to induce capital investment in the thrift and to permit the thrift the flexibility in the near term to turn the fortunes of Western Empire around, could be destroyed at any time for any reason. It is unreasonable to

believe that anyone, least of all Castle Harlan, would agree to a provision that would enable its contracting partner to vitiate the essence of the deal at any time. More importantly, on its face defendant's interpretation is inconsistent with the plain language of the agreement, and accordingly defendant's motion for summary judgment must be denied.

MOTION TO DISMISS CERTAIN PLAINTIFFS

In the event defendant's motion for summary judgment was not granted, defendant moved to dismiss all plaintiffs except Messrs. Castle and Harlan, who were the only two party plaintiffs who signed the RCMA in their individual capacities, and hence, according to the government, who can even argue that they had privity of contract with the government. There is no dispute that none of the other plaintiffs in their individual capacities signed the documents evidencing the agreement. Plaintiff FDIC, in its response to the motion to dismiss, agreed with the government that all plaintiffs except Messrs. Castle and Harlan should be dismissed because of lack of privity.

Private plaintiffs make three general responses to the privity argument. First, plaintiffs, relying primarily on *Far West Federal Bank, S.B. v. Office of Thrift Supervision*, 119 F.3d 1358 (9th Cir. 1997), argue that, when the entire transaction is properly understood, they are either parties, or at least third party beneficiaries, of the contract. Second, plaintiffs argue that, regardless, Judge James T. Turner has ruled that, under 12 U.S.C. § 1821(d)(11), shareholder plaintiffs have a direct interest in any surplus that would result from a recovery to the thrift, and therefore have standing to sue. Third, plaintiffs observe that defendant's motion simply does

not address whether the plaintiffs can maintain their claims for takings under the Fifth Amendment.

As to the second and third of these arguments the court concurs. Judge Turner has already ruled that shareholder plaintiffs in these cases have standing to participate in the litigation pursuant to 12 U.S.C. § 1821(d)(11) and citing the holdings in *Branch v. United States*, 69 F.3d 1571, 1575 (Fed. Cir. 1995), *cert. denied*, 519 U.S. 810 (1996), and *California Housing Sec., Inc. v. United States*, 959 F.2d 955, 957 n.2 (Fed. Cir. 1992), *cert. denied*, 506 U.S. 916 (1992). The court need not revisit that issue. Similarly, plaintiffs are correct that their taking claims survive regardless of defendant's motion to dismiss, since defendant's motion simply does not address the issue of whether any or all of the plaintiffs can maintain takings claims apart from the breach of contract claims.

The remaining question the court needs to address is whether plaintiffs other than Messrs. Castle and Harlan may maintain their direct breach of contract claims. The government repeats, mantra-like, the settled rule that the shareholders, if suing in a non-derivative capacity, must be parties or third party beneficiaries to the contract. Plaintiffs never dispute this settled rule, but argue instead that they are either parties to the contract or third party beneficiaries.

Far West is instructive because the case is factually similar to the one at hand. In *Far West*, the investors, Far West, the FHLBB and the Federal Home Loan Bank of Seattle entered into a series of agreements in 1987, whereby the investors agreed to infuse new capital into Far West (in the form of stock), which was contingent on the conversion of Far West from a mutual into a

stock association. *Far West*, 119 F.3d at 1361. As part of this series of agreements Far West was granted, among other things, the right to treat an intangible asset (a newly created credit line) as an intangible asset, which could be used to meet a Modified Regulatory Capital Requirement in lieu of existing regulatory capital requirements for a period of ten years. None of the investor plaintiffs in *Far West* in an individual capacity signed the Conversion Agreement, which established the Modified Regulatory Capital Requirement. *Id.* at 1362. The Ninth Circuit held that the investor plaintiffs had standing to sue for rescission of the agreement and restitution of their investment.

In *Far West,* the FDIC had argued that the investor plaintiffs did not have standing to sue because the investors did not sign the Conversion Agreement in their individual capacities, but only as directors of Far West. The FDIC argued, as does the government here, that any injuries suffered were suffered by Far West, and that the investors are simply shareholders who are attempting to recover for the harm suffered by the corporation. *Id.* at 1363. The Ninth Circuit strongly disagreed:

> FDIC's argument ignores the nature and circumstances of the entire agreement among the Investors, Far West, FHLBB, and FHLB-Seattle. At the time of the Conversion Agreement, FHLBB made promises to entice the Investors to recapitalize Far West. FHLBB's inability to continue to regulate Far West in accord with those promises unquestionably injured the investors, who were induced by the FHLBB's promises to pour $26.6 million into a failing thrift.

> Under the Restatement, a third party who is an intended beneficiary of a contract may sue to enforce the contract or to obtain an appropriate remedy for breach. *See* Restatement (Second) of Contracts § 304 (1981). The Conversion Agreement specifically identifies both Far West and its prospective shareholders as intended beneficiaries of FHLBB's promises. Furthermore, as discussed above, the circumstances of the transaction indicate that all of the parties intended the benefits of FHLBB's promises to run to the Investors, so that the Investors would be inclined to risk their money in *Far West*. In sum, even though the Investors were not signatories to the Conversion Agreement itself, it is clear that the sole purpose of the entire transaction among the Investors, Far West, FHLBB, and FHLBB-Seattle was for the Investors to invest $26.6 million in Far West in exchange for promises by the FHLBB to regulate Far West in a manner that would make their investment financially sound. To deny the Investors an opportunity to recover for FHLBB's breach simply because Far West and not the Investors signed one of the documents evidencing those promises would place the form of the agreement over its substance. We decline to take such a formalistic and narrow view of the parties' agreement.

Id. at 1363-64 (footnote omitted).

Investor plaintiffs argue that the "nature and circumstances" of their agreement mirror those of the agreement in *Far West*. Like the Far West investors, the investors, save Messrs. Castle and Harlan, did not sign any

of the documents evidencing the agreement. However, the plaintiffs contend, and defendant does not really dispute, that the purpose of this series of agreements, as in *Far West*, was to induce the investors to infuse capital in a failing thrift in exchange for regulatory treatment that "would make their investment financially sound." Plaintiffs therefore argue that, consistent with the logic of *Far West*, the investors were parties to, or third party beneficiaries of, the contract.

Defendant makes several arguments as to why *Far West is* not relevant to the instant dispute. Defendant points out that *Far West* is a Ninth Circuit case, and the court should follow what defendant believes is consistent precedent in this Circuit. Defendant cites several cases, including *Suess v. United States*, 33 Fed. Cl. 89, 94 (1995), *Robo Wash, Inc. v. United States*, 223 Ct. Cl. 693, 697 (1980), and *Algonac Mfg. Co. v. United States*, 192 Ct. Cl. 649, 662, 428 F.2d 1241 (1970), in support of the "settled proposition that privity of contract—and, therefore, standing to sue in a non-derivative capacity—cannot be established unless the claimant identifies a duty and an injury running *directly* to him or her.") Def.'s Consol. Reply at 14. The precedent, while accurately cited, states a general rule that is irrelevant to plaintiffs' argument in favor of standing. Plaintiffs concede the rule, but point out it is irrelevant in this case, because the investor plaintiffs assert that they were parties to the contract or third party beneficiaries of the contract.

Defendant makes two additional factual distinctions in *Far West* that it believes render the case inapposite. First, defendant observes that the documents evidencing the agreement in this case do not specifically identify the

investors as intended beneficiaries, as did the *Far West* Conversion Agreement. This is indisputable but once again hardly dispositive. The Ninth Circuit did note that the Conversion Agreement specifically identified the stockholders as intended beneficiaries, but this only is a point in support of a finding that the stockholders were intended beneficiaries, not a legal rule. The court cannot divine a legal requirement that beneficiaries be specifically identified from the Ninth Circuit's opinion; moreover, such a rule would be flatly contrary to the law of this Circuit. In *Montana v. United States*, 124 F.3d 1269 (Fed. Cir. 1997), the Federal Circuit stated that "[t]he intended beneficiary need not be specifically or individually identified in the contract, but must fall within a class clearly intended to be benefited thereby." *Id.* at 1273.

Defendant's second factual distinction is simply erroneous. Defendant contends that an "unusual sequence of events" in *Far West* distinguish the case from the present one. Defendant states: "The shareholders in *Far West* invested monies in an institution that had been placed under FDIC restrictions *after* the enactment of FIRREA." Defs Consol. Reply at 18. Notwithstanding the ambiguity of this sentence, it is incorrect however one reads it. The *Far West* investors capitalized Far West in 1987; FIRREA passed in 1989. The lawsuit was prompted by regulatory action threatened against Far West by the Office of Thrift Supervision as a result of FIRREA's new capital requirements. In sequencing terms, these actions are identical to those in this case: plaintiffs invested money, FIRREA passed and breached the terms of the contract, and plaintiffs filed suit.

Once again, defendant's objections do not go to the actual issue remaining: whether all the investor plaintiffs except Messrs. Castle and Harlan have standing to sue as either parties to the contract or as third party beneficiaries of the contract. The court believes that these investor plaintiffs are not parties, but are third party beneficiaries of the contract. This is clear after a quick review of the nature and circumstances of the transaction. The parties to the transaction were Messrs. Castle and Harlan, the FHLBB and the FSLIC. The very purpose of the contract, however, as clearly spelled out in the Business Plan of Castle Harlan (and in essence undisputed by the government), was to enshrine a modified regulatory regime under which Western Empire would operate that would induce investors to recapitalize the thrift. The capital these investors would provide was the linchpin of the agreement, not the nominal $2000 Messrs Castle and Harlan paid for the value of the common stock. It was for the investors' benefit, to induce their investments, that the government made its promises.

As the Federal Circuit said in *Montana v. United States*, 124 F.3d 1269 (Fed. Cir. 1997), in order to qualify as a third party beneficiary, "the contract must 'reflect the express or implied intention of the parties to benefit the third party.'" *Id.* at 1273. What's more, as stated previously "intended beneficiary need not be specifically or individually identified in the contract, but must fall within a class clearly intended to be benefited thereby." *Id.* It is clear to the court that the "implied intention" of the parties was to benefit the investors, and that they fall within the class—indeed they comprise the entirety of the class—that was intended to benefit from

the government's promises. Defendant's motion to dismiss is accordingly denied.

PRIOR MATERIAL BREACH DEFENSE

Defendant argues that, even if the court should find that there is a contract, its performance can be excused because of prior material breaches by Western Empire. Defendant points to two actions in the record that it believes evidence prior material breaches. The first is its contention that Western Empire failed to meet the 2 percent tangible capital requirement, and failed to cure the capital deficiency in 90 days, as required by Sections 2(g) and 2(h) of the RCMA. The second prior material breach cited by defendant is Western Empire's alleged failure to abide by two requirements contained in Section 4(a) of the Conditions for Approval: the first is a requirement to provide quarterly reports which include identification of any material variances from the business plan; the second requires prior written approval of the Supervisory Agent of "any proposed material change or deviation from the operating format as presented in the Business Plan."

The court need not spend any time evaluating the standards for whether a breach is material, since the record squarely contradicts defendant's first grounds for asserting this defense and provides absolutely no evidence whatsoever in support of the second. As to the failure to meet the capital deficiency, the documents relied upon by the government argue against there being a breach, material or not. The government contends that Western Empire was capitally deficient as of June 5, 1989, and that it failed to cure that deficiency within the prescribed 90 days. The only problem is that the Exam Report of the Office of Thrift Supervision (an

agency, incidentally, that did not exist prior to the August 6, 1989 passage of FIRREA), clearly states otherwise.[26] Western Empire was clearly compliant with its agreement when FIRREA was passed. As to Western Empire's alleged failure to either notify federal regulators or seek approval for material deviations, the record citations relied upon by defendant are not inconsistent with Western Empire's obligations pursuant to the Conditions for Approval. Most tellingly, there is no evidence that the regulators considered these to be violations of plaintiffs' obligations.[27]

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[26] "The institution's board and management were notified of the deficiency in a letter dated September 12, 1989, and directed to cure such deficiency within 90 days as required within the Capital Maintenance Agreement." Under the government's current interpretation, the cure period would have ended September 5, 1989. Defendant's curious interpretation would mean that the OTS provided a 90-day notice to cure seven days after the cure period had expired! This interpretation can only be described charitably as odd.

[27] The government relies upon two examples The first is a line in the OTS Exam Report noting "significant discrepancies" between the income projected in the operating plan and the actual results as of June 30, 1989. It says nothing about failure to notify or get approval of deviations to the business plan. The second is a passing footnote reference to Western Empire's acknowledged loan-to-one-borrower violation prior to the enactment of FIRREA. As plaintiffs point out, the violation was quickly cured, and the government never contended that this was a material breach that excused its nonperformance prior to the initiation of this lawsuit. It also is preposterous to believe, as plaintiffs point out, that the investors' $15 million investment could stand or fall on every such minor regulatory issue. Most relevantly, the contracting parties clearly did not think, or act, as if it did.

CONCLUSION

For the reasons set forth above, defendant's motion for summary judgment and motion to dismiss are denied, and the motions for summary judgment as to liability of the investor plaintiffs, and the FDIC as successor in interest to the rights of New Western Empire Savings and Loan Association, are granted.

It is further ORDERED that, pursuant to RCFC 77(f), the Omnibus Case Management Order (September 18, 1996) and the Priority Cases Pretrial Scheduling Order (April 2, 1997), this case is assigned for all further proceedings to Judge John P. Wiese as Trial Judge.

IT IS SO ORDERED.